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Transforming Urban Markets for the Poor through Collaborative Entrepreneurship

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This special issue of *Global Urban Development Magazine* is the result of collaboration with Ashoka, and we want to especially thank Stephanie Schmidt, Valeria Budinich, and Aileen Nowlan of Ashoka, and Bruce Ferguson of Global Urban Development, for assembling a series of papers that focus on the role of the private sector in meeting the challenges of affordable housing and urban economic and community development. The issue is available online at: www.globalurban.org/GUDMag08Vol4Iss2/MagHome.htm

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Transforming Urban Markets for the Poor through Collective Entrepreneurship

Editorial from Ashoka for the Global Urban Development Journal - November 2008

Foreword from Bill Drayton – exerpt from The Everyone a Changemaker Vision
As part of its second generation of programs Ashoka started to advance what we have gracefully named business/social "hybrid value-added chains" (HVAC). This work originated in a major "mosaic" collaboration involving across roughly 400 Ashoka social entrepreneurs whose work is focused on ensuring full economic citizenship to everyone. A good many of those working toward this goal have found powerful leverage in reconnecting business with the newly entrepreneurial/competitive citizen sector through new value added chains involved in design, production, distribution, servicing, and parallel supports including finance. The new, more productive value added chains draw for each step in the chain whatever each side can contribute most effectively and efficiently. These hybrid value-added chains represent an important source of new investment opportunities for for-profit finance firms entering the social financial services business.

Ashoka's HVAC strategy is to get four very different products/services quickly to the point where the customers, businesses, and citizen groups are all benefiting enormously from the new cooperative value-added chains. Once the businesses in an industry see one of their competitors gaining important new markets and making significantly higher profits, they cannot afford not to follow. The same is true for the organizations that compete with the pioneer HVAC citizen groups, once they see how much their competitors are benefiting from large, stable, nonpolitical, new revenues and their new, unique ability to provide valued new services to their clients. This competitive dynamic is key to the jujitsu that allows Ashoka, a small force, to set in motion so large and irreversible an historical change.

In order to achieve such transformation, what we must do now is increase the proportion of humans who know that they can cause change. And who, like smart white blood cells coursing through society, will stop with pleasure whenever they see that something is stuck or that an opportunity is ripe to be seized. Multiplying society's capacity to adapt and change intelligently and constructively and building the necessary underlying collaborative architecture, is the world's most critical opportunity now. Pattern-changing leading social entrepreneurs are the most critical single factor in catalyzing and engineering this transformation.[1]

Business, the most financially innovative and efficient sector of all, has no direct mechanism to apply its practices to the goal of eliminating poverty. *Muhammad Yunus*

What is at stake:

[1] As Ashoka has come to understand this more clearly, it has clarified its ultimate goal. Challenged several years ago by eBay's Pierre Omidyar, Ashoka came to understand, given its understanding of these historical forces it came into being to serve, that its ultimate goal is an "everyone a changemaker" world. Before that, it had talked chiefly in terms of the intermediate goal of building an entrepreneurial/competitive citizen sector.

Liliana, a divorced mother of five, lives in a favela in the suburbs of Sao Paolo. She earns about $200 a month as an informal seamstress. She owns a house with one bathroom, one kitchen and one family room that she has spent about six years to build. She has invested about $3,000 to date in her home, when she was able to put some money aside or borrowing from friends. Since she bought a plot of land from a municipality official when arriving to the Sao Paulo region from her native village she believed to have a valid title to her plot. But the development was illegal and that piece of paper she holds dearly is not a formal title that she can use as collateral. Her house has no sewage system and she uses illegal water and electricity connections, which are free if one forgets that supply not always stable and Liliana has to pay someone to reconnect them from time to time.

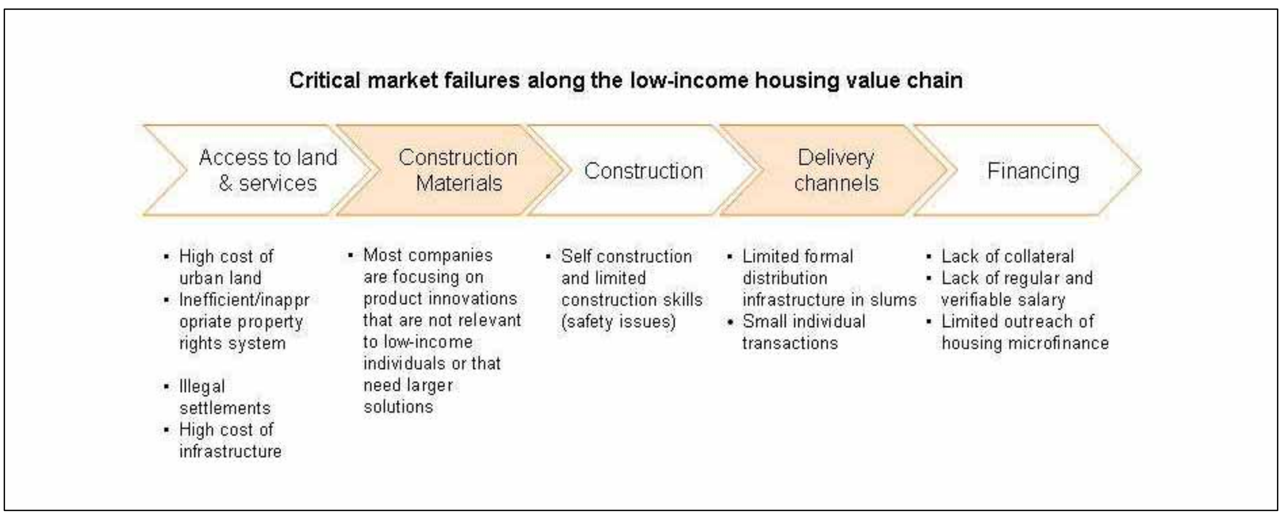
Liliana has a dream of adding a second floor and improving her house, to provide a more dignified place to her children and maybe open a small shop, but she has no bank account, no collateral typically used by banks beyond a TV and few other house appliances and no pay slip at the end of the month. She qualifies, though, for 257% a year consumer loans, that she resorts to from time to time. Community spirit is low so she will have to hire a "half-spoon", an unqualified construction worker. Under the current conditions Liliana will pay $8,000 to incorporate about $4,000 doubtful quality improvements to her home, brick by brick.

Ten eye-opening facts on low-income housing markets	
1. World slum population	1 billion
2. New slum residents per week	500,000
3. Percentage of urban population living in slums	>98% – Chad, Ethiopia 72% – Sub Saharan Africa 57% – South Asia 31% – Latin America 6% – Developed countries
4. Population density per hectare	3,000 in Kibera slum (Kenya) 37 in Washington DC
5. Size of low-income markets	$332 billion – housing $158 billion – health $51 billion – ICT
6. Total estimated dead capital in informal housing	$9.3 trillion
7. Dead capital per square mile in Dharavi slum, Mumbai	$10 billion
8. Annual interest rate on unsecured lending in Brazil	77% to 257%
9. Mortgage lending as a percentage of Gross Domestic Product	2% – Brazil 7% – Colombia 54% – Germany 75% – United States
10. Percentage of Millennium Challenge Corporation funds dedicated to Housing and Shelter	5%

Liliana is not an isolated case. The year 2007 marked a turning point in history, with one out of every two people living in a city. One-sixth of the world's population -- one billion people -- live in urban slums in emerging countries. In addition, virtually all net growth of 2.6 billion in world population between now and 2050 is projected to occur in these cities. In effect, relatively poor nations will build the equivalent of a city of more than one million people each week for the next 45 years. Many of the urban inhabitants in slums face tenuous employment and precarious living situations. And the proportion of slum dwellers under 25 is increasing, making slums a place where disillusionment could be dangerous.

Breakdowns in the low income housing value chain

Collectively, the poor have massively invested in their homes. However, they do so in the most adverse conditions. They face inefficient or non-existent property rights systems, often compromised by corruption between developers and local officials. They find construction materials that may be of low-quality or unsuited to their needs, yet are priced more per unit than a higher income client would have to pay. Low-income people often build their own homes progressively, whenever they have the money available. Many utilize informal advice and labor from neighbors and friends, which often leads to unsafe structures. Delivery channels in slums are limited by the reluctance of formal companies to deal with small individual transactions, not recognizing the aggregate demand in slum communities. Finally, poor households have to pay cash or borrow at high rates from moneylenders or consumer lending institutions. In most developing countries, access to land and adequate financing are critical ingredients to mend the dysfunctional housing system, although other products and services such as affordable quality construction materials are also required. Absent major change, the bulk of urban development will occur informally, outside formal markets at tremendous public and private cost.



All indicates that low-income urban households are the markets of the future. Low income housing markets were recently estimated at about $330 billion[2]. Despite this, housing has not received as much attention; for example, only 5% of the Millennium Challenge Corporation's funding is directed to housing.[3] Yet housing is a human right in itself. It is a springboard for human and economic development that can impact the health, security, income flow and self-esteem of poor families who are also more vulnerable to climate change risks, as precarious housing is threatened by flooding, sea-level rise, and extreme weather patterns.[4]

The core question that we would like to explore with readers in this special issue of the Global Urban Development Journal is precisely how to address the housing market failures that low-income families are facing around the world. How to develop, operate and scale transformative business models that are adapted to the reality of low-income communities around the world: small-sized transactions, informal economy and lack of traditional distribution channels. How to think creatively beyond individual construction-related products or low-cost technologies to develop sustainable urban markets.

A changing landscape of innovations and opportunities

The pressures on slum communities have prompted national and international networks that share experience and strengths, such as Slum Dwellers International and the Asian Coalition for Housing Rights (ACHR). ACHR has worked with over 50,000 households in Thailand to upgrade, re-block, or relocate communities, fostering creativity, hope, and unleashing commercial growth potential in urban spaces. Experimentations in low-income housing are emerging around the world, from sanitation improvements to community mobilizing that touches hundreds of families at a time.

Similarly, new financing schemes for home improvement and new homes have rapidly developed over the last few years with the expansion of housing microfinance. Several models have been demonstrated successfully but they are still benefitting only a fraction of the population given that traditional microfinance is serving about ten percent of the market and housing microfinance is a subset of microfinance[5]. With regards to products, innovation in low-cost housing technologies continues even though it is often not available to low-income consumers due to lack of financing or delivery systems : a vicious circle.

Overall, new solutions and models are serving only a fraction of the population; they are fragmented and often limited to one sector – be it the public, private or citizen sector. Government housing programs have evolved based on experience but tend to be slow-moving and fickle. Many of them still ignore market forces, informal processes and low-income

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[2] The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid. Washington, DC: World Resources Institute and International Finance Corporation, 2007

[3] Joseph F. Lombardo, Jr. and Kerstin Tebbe: Estimate of the Millennium Challenge Corporation's Urban and Shelter-Based Investments: International Housing Coalition, April 2008

[4] Gordon McGranahan: Urban environments, wealth and health: shifting burdens and possible responses in low and middle-income nations. IIED Human Settlements Program, 2007

[5] See Bruce Ferguson's article in this journal; "Housing microfinance; is the glass half empty or half full?" for a full discussion of housing microfinance

communities' norms such as progressive housing and the desire to choose one's neighbors. In the other sectors, citizen sector initiatives are easily fragmented, and only a few "enlightened" companies have stepped into low-income housing with the energy and commitment required. How do we broaden access to financing and complementary services across multiple distribution channels in low-income communities - such as retailers, banks or community-based organizations, in addition to microfinance organizations? How do we bring all of these solutions together in cost-effective "last mile" solutions?

The current "silent" revolution of the citizen sector could offer new opportunities for low-income housing and urban development.[6] Although the business sector has had an edge in being entrepreneurial and competitive since the industrial revolution, since the eighties the citizen sector has been rapidly catching up. The citizen sector has been growing explosively, generating jobs two and a half to three times as fast as business.[7] The citizen sector is also becoming more professional, led by leading social entrepreneurs and local changemakers. There are now millions of modern, competing citizen groups, including large, sophisticated second-generation organizations, in Brazil, North America, Europe, and Southeast Asia.
No sector alone can meet the challenge of low-income housing. In order to provide housing with dignity for one billion and slum dwellers, the business, citizen, and government sectors need to work together. For example, citizen sector organizations may have knowledge of what low-income people need, how they make investment decisions, and whom they trust. They speak to low-income people daily in places where companies fear to tread. Leading citizen sector organizations know how to change behaviors and mindsets and foster collective action, be they introducing women's savings groups, sanitation, or anti-corruption campaigns. Leading businesses bring expertise in product design and marketing, acquiring and allocating capital, managing large-scale operations, information systems and performance management. Federal and local governments need to lead efforts towards effective land tenure, infrastructure and business-friendly environments.

Ashoka's vision is a world in which CSOs and businesses collaborate, compete and learn to serve low-income markets with new business models, enabled by governments. A world in which every person participates as a full economic citizen, improving their lives by having access to affordable products and services, being able to work and get paid, and leveraging their assets.

Structure of the Journal

As an increasing number of financially self-sustaining models are developed to serve low-income markets, new opportunities emerge for players involved in housing, basic services, urban development and finance. There is a need for new business models combining profits and social impact, new roles, new investment mechanisms, new policy frameworks and new

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[6] Defined as an organization primarily seeking social value. Ashoka has adopted the terms "Citizen Sector" and "Citizen Sector Organization" instead of negative definitions such as "Non-Profit" and "Non Governmental Organizations". The scope of these organizations may range from economic development to health, education, environment, etc.
[7] Ashoka analysis

mindsets -- all these driven by innovation and competition. The aim of this magazine is therefore to inspire new players to explore the social and financial potential of low income housing and urban development, to equip existing players with practical "how to's" and to trigger a dialogue about collective entrepreneurship. Our goal is to foster a learning community of business, social and public entrepreneurs to learn from previous experiences, keep refining our understanding of obstacles and success factors to drive transformative solutions at a big scale and innovate together.

This issue will provide perspectives on both micro and macro dimensions related to the low-income housing and urban development issues. It will discuss models to develop, operate and scale transformative market-based models that are adapted to the reality of low-income communities around the world and that goes beyond specific products or low-cost technologies to offer comprehensive solutions. We included a select number of cases and articles of pioneers in the field presenting insights on issues such as: What do low-income households need? How do they make decisions? How can businesses get started with low-income market initiatives? What steps have successful ventures taken to address the strategic, managerial and cultural challenges of serving the poor? What are the competitive advantages of businesses and CSOs in the different steps of a value chain?

This special issue is divided into six thematic parts structured to reflect various enabling factors for low-income housing markets and urban development:

Core topics	Articles	Descriptions
How to assess the size of low income housing markets	The Next Billion – the Housing Market	Quantifies and explains the potential market for low-income housing around the world based on household expenditure patterns
	A Value Chain Framework for Affordable Housing in Emerging Countries	Introduces the scale of the problem in urban, and discusses the market potential that arises from understanding low-income housing needs, such as progressive informal building
How to mobilize and empower communities to transform urban markets	The Capacity of Poor Women to Make Productive Investments	Examines how low-income women in the Dominican Republic manage their finances, including savings, housing, and starting and growing businesses
	Social Market Development and Social Mobilization in the Value Chain of the Construction Industry	Discusses the advantage of working with social movements in Brazil to gain understanding of what low income people want in housing
	Understanding Asian Cities	Discusses in-depth insights about recent developments in Asian cities, including contradictions within cities, roles of different actors, and the transformative impact of the citizen sector

Core topics	Articles	Descriptions
How to unlock these markets addressing the issue of land tenure	Market-Based Models for Land Development for the Low/Moderate-Income Majority	Analyzes the gaps in the value chain that hinder low income housing, describes progressive housing as a technique, and analyzes relative strengths and weaknesses of two approaches to providing low income housing, in Pakistan and El-Salvador
How to mobilize financing for these markets	Understanding the Link between Land Issues and the Availability of Financing for Low and Middle Income Families	[Irene Vance]
	Housing Microfinance; is the Glass Half Empty or Half Full?	Discusses the current state of housing microfinance, and describes specific development from Peru, Mexico and Brazil. In light of persistent unmet demand, provides recommendations to provide housing micro-finance at scale
How to innovate business models	Tapping into Private Sector Financing for Housing Microfinance Operations	[James Magowan]
	Finance for Housing	Analyzes current sources of financing for low income housing, state and international financing options, and the need for further al services for housing
	Housing the Poor by Engaging the Private and Citizen Sectors: Social nnovations and Hybrid Chains	Explains the unique advantages of involving both the private and citizen sectors in commercial collaborations for low income housing and provides examples of innovative business model
How to create an enabling environment for private initiatives in urban development	Bringing Low-Income Consumers into the Market in Colombia: Home Improvements that Make a Difference	Describes Colceramica's business model supporting progressive housing for low income people in Colombia, including history, challenges, changes that were required, and prospects for growth
	Private Sector Initiatives in Slum Housing	Discusses the barriers to private sector involvement in low-income housing, including land tenure and the need for public investment, as well as the opportunities for private sector contributions to low income housing
	Climate Prosperity Plan	[Susan Blaustein]

About Ashoka

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Ashoka's work on Hybrid Value Chains originates from the work of a significant group of Fellows around the world whose work is focused on ensuring full economic citizenship to everyone. Several of these social entrepreneurs working toward this goal have found powerful leverage in connecting business with the increasingly competitive citizen sector through new value chains for products/ services design, production, distribution, servicing and cross-cutting support like financing. The new business-social value chains draw whatever each side can contribute most effectively for each step in the chain.

Ashoka' strategy is to demonstrate the Hybrid Value Chain (HVC) model in several industries to the point where the customers, businesses and citizen groups all significantly benefit from the new value chains. Beyond specific business-social partnerships, our goal is to transform sectors and reach an irreversible change in the relationships of the business and citizen sectors. To do so, we are demonstrating the HVC concept through a series of business-social ventures in low-income housing, healthcare and small producers' economies. With the support of the Hilti Foundation and in collaboration with its community of social entrepreneurs, Ashoka launched a multi-country Housing for All program in 2007, starting with Brazil and India.

For more information, visit us at: www.ashoka.org or contact us at fec@ashoka.org

CREATING A WORLD WITHOUT POVERTY:
SOCIAL BUSINESS AND THE FUTURE OF CAPITALISM

Muhammad Yunus

1. A New Kind of Business

Since the fall of the Soviet Union in 1991, free markets have swept the globe. Free-market economics has taken root in China, Southeast Asia, much of South America, Eastern Europe, and even the former Soviet Union. There are many things that free markets do extraordinarily well. When we look at countries with long histories under capitalist systems—in Western Europe and North America—we see evidence of great wealth. We also see remarkable technological innovation, scientific discovery, and educational and social progress. The emergence of modern capitalism three hundred years ago made possible material progress of a kind never before seen. Today, however—almost a generation after the Soviet Union fell—a sense of disillusionment is setting in.

To be sure, capitalism is thriving. Businesses continue to grow, global trade is booming, multinational corporations are spreading into markets in the developing world and the former Soviet bloc, and technological advancements continue to multiply. But not everyone is benefiting. Global income distribution tells the story: Ninety-four percent of world income goes to 40 percent of the people, while the other 60 percent must live on only 6 percent of world income. Half of the world lives on two dollars a day or less, while almost a billion people live on less than one dollar a day.

Poverty is not distributed evenly around the world; specific regions suffer its worst effects. In sub-Saharan Africa, South Asia, and Latin America, hundreds of millions of poor people struggle for survival. Periodic disasters, such as the 2004 tsunami that devastated regions on the Indian Ocean, continue to kill hundreds of thousands of poor and vulnerable people. The divide between the global North and South—between the world's richest and the rest—has widened.

Some of the countries that have enjoyed economic success over the past three decades have paid a heavy price, however. Since China introduced economic reforms in the late 1970s, it has experienced rapid economic growth, and, according to the World Bank, over 400 million Chinese have escaped poverty. (As a result, India has now become the nation with the largest population of poor people, even though China has a bigger overall population.)

But all of this progress has brought with it a worsening of social problems. In their rush to grow, Chinese officials have looked the other way when companies polluted the water and air. And despite the improved lot of many poor, the divide between the haves and have-nots is widening. As measured by technical indicators such as the Gini coefficient, income inequality is worse in China than in India.

Even in the United States, with its reputation as the richest country on earth, social progress has been disappointing. After two decades of slow progress, the number of people living in poverty has increased in recent years.[1] Some forty-seven million people, nearly a sixth of the population, have no health insurance and have trouble getting basic medical care. After the end of the Cold War, many hoped for a "peace dividend"—defense spending could decline, and social programs for education and medical care would increase. But especially since September 11, 2001, the U.S. government has focused on military action and security measures, ignoring the poor.

These global problems have not gone unnoticed. At the outset of the new millennium, the entire world mobilized to address them. In 2000, world leaders gathered at the United Nations and pledged, among other goals, to reduce poverty by half by 2015. But after half the time has elapsed, the results are disappointing, and most observers think the Millennium Goals will not be met. (My own country of Bangladesh, I'm happy to say, is an exception. It is moving steadily to meet the goals and is clearly on track to reduce poverty by half by 2015.)

What is wrong? In a world where the ideology of free enterprise has no real challenger, why have free markets failed so many people? As some nations march toward ever greater prosperity, why has so much of the world been left behind?

The reason is simple. Unfettered markets in their current form are not meant to solve social problems and instead may actually exacerbate poverty, disease, pollution, corruption, crime, and inequality.

I support the idea of globalization—that free markets should expand beyond national borders, allowing trade among nations and a continuing flow of capital, and with governments wooing international companies by offering them business facilities, operating conveniences, and tax and regulatory advantages. Globalization, as a general business principle, can bring more benefits to the poor than any alternative. But without proper oversight and guidelines, globalization has the potential to be highly destructive.

Global trade is like a hundred-lane highway criss-crossing the world. If it is a free-for-all highway, with no stoplights, speed limits, size restrictions, or even lane markers, its surface will be taken over by the giant trucks from the world's most powerful economies. Small vehicles—a farmer's pickup truck or Bangladesh's bullock carts and human-powered rickshaws—will be forced off the highway.

In order to have win-win globalization, we must have fair traffic laws, traffic signals, and traffic police. The rule of "the strongest takes all" must be replaced by rules that ensure that the poorest have a place on the highway. Otherwise the global free market falls under the control of financial imperialism.

In the same way, local, regional, and national markets need reasonable rules and controls to protect the interests of the poor. Without such controls, the rich can easily bend conditions to their own benefit. The negative impact of unlimited single-track capitalism is visible every day—in global corporations that locate factories in the world's poorest countries, where cheap labor (including children) can be freely exploited to increase profits; in companies that pollute the air, water, and soil to save money on equipment and processes that protect the environment; in deceptive marketing and advertising campaigns that promote harmful or unnecessary products.

Above all, we see it in entire sectors of the economy that ignore the poor, writing off half the world's population. Instead, businesses in these sectors focus on selling luxury items to people who don't need them, because that is where the biggest profits are.

I believe in free markets as sources of inspiration and freedom for all, not as architects of decadence for a small elite. The world's richest countries, in North America, Europe, and parts of Asia, have benefited enormously from the creative energies, efficiencies, and dynamism that free markets produce. I have devoted my life to bringing those same benefits to the worlds most neglected people—the very poor, who are not factored in when economists and business people speak about the market. My experience has shown me that the free market—powerful and useful as it is—could address problems like global poverty and environmental degradation, but not if it must cater solely and relentlessly to the financial goals of its richest shareholders.

Is Government the Answer?

Many people assume that if free markets can't solve social problems, government can. Just as private businesses are devoted to individual profit, government is supposed to represent the interests of society as a whole. Therefore, it seems logical to believe that large-scale social problems should be the province of government.

Government can help create the kind of world we all want to live in. There are certain social functions that can't be organized by private individuals or private organizations—national defense, a central bank to regulate the money supply and the banking business, a public school system, and a national health service to ensure medical care for all and minimize the effects of epidemics. Equally important, government establishes and enforces the rules that control and limit capitalism—the traffic laws. In the world economy, rules and regulations concerning globalization are still being debated. An international economic regulatory regime has yet to fully emerge. But on the national and local levels, many governments do a good job of policing free markets. This is especially true in the industrialized world, where capitalism has a long history and where democratic governments have gradually implemented reasonable regulatory systems.

The traffic laws for free markets oversee inspection of food and medicine and include prohibitions against consumer fraud, against selling dangerous or defective products, against false advertising and violation of contracts, and against polluting the environment. These laws also create and regulate the information framework within which business is conducted—the operation of stock markets, disclosure of company financial information, and standardized accounting and auditing practices. These rules ensure that business is conducted on a level playing field.

The traffic laws for business are not perfect, and they are not always enforced well. Thus some companies still deceive consumers, foul the environment, or defraud investors. These problems are especially serious in the developing world, with its often weak or corrupt governments. In the developed world, governments usually perform their regulatory tasks reasonably well, although starting in the 1980s, conservative politicians have taken every opportunity to undermine government regulations.

However, even an excellent government regulatory regime for business is not enough to ensure that serious social problems will be confronted, much less solved. It can affect the way business is done, but it cannot address the areas that business neglects. Business cannot be mandated to fix problems; it needs an incentive to want to do so. Traffic rules can make a place for small cars and trucks and even rickshaws on the global economic highway. But what about the millions of people who don't own even a modest vehicle? What about the millions of women and children whose basic human needs go unmet? How can the bottom half of the world's population be brought into the mainstream world economy and given the capability to compete in the free market? Economic stop signs and traffic police can't make this happen.

Governments have long tried to address these problems. During the late Middle Ages, England had Poor Laws to help those who might otherwise starve. Modern governments have programs that address social problems and employ doctors, nurses, teachers, scientists, social workers, and researchers to try to alleviate them.

In some countries, government agencies have made headway in the battle against poverty, disease, and other social ills. Such is the case with overpopulation in Bangladesh, which is one of the world's most densely populated countries, with 145 million people in a land area the size of Wisconsin. Or, to put it another way, if the *entire population of the world* were squeezed into the area of the United States of America, the resulting population density would be *slightly less* than exists in Bangladesh today! However, Bangladesh has made genuine progress in alleviating population pressure. In the last three decades, the average number of children per mother has fallen from 6.3 in 1975 to 3.3 in 1999, and the decline continues. This remarkable improvement is largely due to government efforts, including the provision of family planning products, information, and services through clinics around the country. Development and poverty-alleviation efforts by nongovernmental organizations, or NGOs, as well as Grameen Bank have also played an important role.

Governments can do much to address social problems. They are large and powerful, with access to almost every corner of society, and through taxes they can mobilize vast resources. Even the governments of poor countries, where tax revenues are modest, can get international funds in the form of grants and low-interest loans. So it is tempting to simply dump our world's social problems into the lap of government and say, "Here, fix this."

But if this approach were effective, the problems would have been solved long ago. Their persistence makes it clear that government alone does not provide the answer. Why not?

There are a number of reasons. One is that governments can be inefficient, slow, prone to corruption, bureaucratic, and self-perpetuating. These are all side effects of the advantages governments possess: Their vast size, power, and reach almost inevitably make them unwieldy as well as attractive to those who want to use them to amass power and wealth for themselves.

Government is often good at creating things but not so good at shutting them down when they are no longer needed or become burdens. Vested interests—especially jobs—are created with any new institution. In Bangladesh, for example, workers whose sole job was to wind the clocks on the mantelpieces of government administrators retained their positions, and their salaries, for many years after wind-up clocks were superseded by electrical timepieces.

Politics also stands in the way of efficiency in government. Of course, "politics" can mean "accountability." The fact that groups of people demand that government serve their interests and put pressure on their representatives to uphold those interests is an essential feature of democracy.

But this same aspect of government sometimes means that progress is thwarted in favor of the interests of one or more powerful groups. For example, look at the illogical, jerry-rigged, and inefficient health-care system in the United States, which leaves tens of millions of people with no health insurance. Reform of this system has so far been impossible because of powerful insurance and pharmaceutical companies.

These inherent weaknesses of government help to explain why the state-controlled economies of the Soviet era ultimately collapsed. They also explain why people around the world are dissatisfied with state-sponsored solutions to social problems.

Government must do its part to help alleviate our worst problems, but government alone cannot solve them.

The Contribution of Nonprofit Organizations

Frustrated with government, many people who care about the problems of the world have started nonprofit organizations. Nonprofits may take various forms and go under many names: not-for-profits, nongovernmental organizations, charitable organizations, benevolent societies, philanthropic foundations, and so on.

Charity is rooted in basic human concern for other humans. Every major religion requires its followers to give to the needy. Especially in times of emergency, nonprofit groups help get aid to desperate people. Generous assistance from people within the country and around the world has saved tens of thousands of lives in Bangladesh after floods and tidal waves.

Yet nonprofits alone have proven to be an inadequate response to social problems. The persistence and even worsening of global poverty, endemic disease, homelessness, famine, and pollution are sufficient evidence that charity by itself cannot do the job. Charity too has a significant built-in weakness: It relies on a steady stream of donations by generous individuals, organizations, or government agencies. When these funds fall short, the good works stop. And as almost any director of a nonprofit organization will tell you, there is never enough money to take care of all the needs. Even when the economy is strong and people have full purses, there is a limit to the portion of their income they will donate to charity. And in hard times, when the needs of the unfortunate are greatest, giving slows down. Charity is a form of trickle-down economics; if the trickle stops, so does help for the needy.

Relying on donations creates other problems. In countries where the social needs are greatest—Bangladesh, elsewhere in South Asia, and in large parts of Latin America and sub-Saharan Africa—the resources available for charity are usually very small. And it is often difficult to get donors from the richest countries to take a sustained interest in giving to distant countries they may never have visited, to benefit people they will never know. This is understandable, but it leaves serious social problems in those countries unaddressed.

The problems become even greater in times of crisis—when a natural disaster strikes, when war causes population upheavals and suffering, when an epidemic strikes, or when environmental collapse makes whole districts unlivable. The demand for charity quickly outpaces the supply. And today, with news and information constantly coming in from around the world, the demands for our attention and concern have never been greater. Dramatic disasters reported on television absorb the lion's share of charitable giving, while less publicized calamities that may be equally destructive are ignored. And eventually, "compassion fatigue" sets in, and people simply stop giving.

As a result, there is a built-in ceiling to the reach and effectiveness of nonprofit organizations. The need to constantly raise funds from donors uses up the time and energy of nonprofit leaders, when they should be planning the growth and expansion of their programs. No wonder they don't make much progress in their battles against social problems.

For all the good work that nonprofits, NGOs, and foundations do, they cannot be expected to solve the world's social ills. The very nature of these organizations as defined by society makes that virtually impossible.

Multilateral Institutions—The Development Elite

There is another category of organizations known as *multilateral institutions*. These are sponsored and funded by governments. Their mission is to eliminate poverty by promoting economic development in countries and regions that are lagging behind the prosperous nations of the northern hemisphere. Among the multilateral institutions, the World Bank leads the way. The World Bank has a private sector window called the International Finance Corporation. There are also four regional development banks, which closely follow the lead of the World Bank.

Unfortunately, in practice, the multilaterals have not achieved much in attaining their professed social goals either. Like governments, they are bureaucratic, conservative, slow-moving, and often self-serving. Like nonprofits, they are chronically underfunded, difficult to rely upon, and often inconsistent in their policies. As a result, the hundreds of billions of dollars they have invested over the past several decades have been largely ineffective—especially when measured against the goal of alleviating problems like global poverty.

Multilateral institutions like the World Bank name elimination of poverty as their overarching goal. But they focus exclusively on pursuing this goal through large-scale economic growth. This means that, as long as gross domestic product (GDP) is increasing in a country or a region, the World Bank feels that it is achieving its mission. This growth may be excruciatingly slow; it may be occurring without any benefits to the poor; it may even be occurring at the expense of the poor—but none of this persuades the World Bank to change its policies.

Growth is extremely important in bringing down poverty—there is no doubt about it. But to think that the only way to reduce poverty is to promote growth drives the policymaker to a straight theoretical path of building infrastructure to promote industrialization and mechanization.

There is a debate about the type of growth we should pursue based on serious concerns about the hazards of the World Bank's approach. "Pro-poor growth" and "anti-poor growth" are often treated as separate policy options. But my concern is different. Even if the policymaker identifies and works only for pro-poor growth, he is still missing the real issue. The objective of the policymaker is obviously to generate a spin in the economy so that the poor people are drawn into the spin. But in this conceptualization, the poor people are looked at as objects. In this frame of mind, policymakers miss the tremendous potential of the poor, particularly poor women and the children of poor families. They cannot see the poor as independent actors. They worry about the health, the education, and the jobs of the poor. They cannot see that the poor people can be actors themselves. The poor can be self-employed entrepreneurs and create jobs for others.

Furthermore, in their pursuit of growth, policymakers are focusing on efforts to energize well-established institutions. It never occurs to them that these institutions themselves may be contributing to creating or sustaining poverty. Institutions and policies that created poverty cannot be entrusted with the task of eliminating it. Instead, new institutions designed to solve the problems of the poor need to be created.

Another problem arises from the channel that donors use for the selection and implementation of projects. Both bilateral and multilateral donors work almost exclusively through the government machine. To make a real impact, they should be open to all segments of society and be prepared to utilize the creative capacity that is lying outside the government. I am sure that once donors begin to reach beyond the government, they'll come up with many exciting innovations. They can start with small projects and then let them grow if they see positive results.

Over the years, I have been watching the difference between the business styles of the World Bank and Grameen Bank. Theoretically, we are in the same business—helping people get out of poverty. But the ways in which we pursue this goal are very different.

Grameen Bank has always believed that if a borrower gets into trouble and cannot pay back her loan, it is our responsibility to help her. If we have a problem with our borrower, we tell ourselves that she is right—that we must have made some mistake in our policies or in our implementation of those policies. So we go back and fix ourselves. We make our rules very flexible so that they can be adjusted to the requirements of the borrower.

We also encourage our borrowers to make their own decisions about how to use the loans. If a borrower asks a Grameen staff member, "Please tell me what would be a good business idea for me," the staff member is trained to respond this way: "I am sorry, but I am not smart enough to give you a good business idea. Grameen has lots of money, but no business ideas. That's why Grameen has come to you. You have the idea, we have the money. If Grameen had good business ideas, instead of giving the money to you, it would use the money itself and make more money."

We want our borrowers to feel important. When a borrower tries to shy away from a loan offer, saying that she has no business experience and does not want to take money, we work to convince her that she can come up with an idea for a business of her own. Will this be her very first experience of business? That is not a problem. Everything has to have a beginning somewhere, we tell her.

It is quite different with the World Bank. If you are lucky enough to be funded by them, they give you money. But they also give you ideas, expertise, training, plans, principles, and procedures. Your job is to follow the yellow lines, the green lines, and the red lines—to read the instructions at each step and obey them precisely. Yet, despite all this supervision, the projects don't always work out as planned. And when this happens, it is the recipient country that usually seems to bear the blame and to suffer the consequences.

There are also big differences in the incentive systems in the two organizations. In Grameen Bank, we have a five-star evaluation and incentive system for our staff and our branches. If a staff member maintains a 100 percent repayment record for all his borrowers (usually 600), he gets a green star. If he generates profit through his work, he gets another star—a blue star. If he mobilizes more in deposits than the amount of his outstanding loans, he gets a third star—a violet star. If he makes sure all the children of all his borrowers are in school, he gets a brown star. Finally, if all his borrowers move out of poverty, he gets a red star. The staff member can display the stars on his chest. He takes tremendous pride in this accomplishment.

By contrast, in the World Bank, a staff member's success is linked to the amount of the loans he has successfully negotiated, not the impact his work has made. We don't even consider the amount of loans made by a staff member in our reward system.

There have been campaigns to close down the World Bank and the International Monetary Fund. I have always opposed such campaigns. These are important global institutions created for very good causes. Rather than close them down, we should overhaul them completely. The world has changed so much since the time they were created, it is time to revisit them. It is obvious that the present architecture and work procedures are not adequate to do the job. If I were asked about my ideas, I'd emphasize the following:

- A new World Bank should be open to both government and private investors, with private investment following the social business model I will describe.
- It should work through governments, NGOs, and the new type of organization I am proposing in this book—social businesses.
- Instead of the International Finance Corporation, the World Bank should have another window—a social business window.
- The president of the World Bank should be selected by a search committee that will consider qualified candidates from anywhere in the world.
- The World Bank should work through semi-autonomous national branches, each with its own board of advisors, rather than powerless country offices.
- Evaluation of the staff should be related to the quality of their work and the impact it has made, not the volume of loans negotiated. If a project fails or performs poorly, the staff member involved in designing and promoting it should be held responsible.
- The World Bank should grade all projects each year on the basis of their impact on poverty reduction, and each country office should be graded on the same basis.

Corporate Social Responsibility

Still another response to the persistence of global poverty and other social ills has been a call for social responsibility on the part of business. NGOs, social activists, and politicians have put pressure on corporations to modify their policies in regard to labor, the environment, product quality, pricing, and fair trade.

To their credit, many businesses have responded. Not so long ago, many executives managed corporations with a "public be damned" attitude. They exploited their workers, polluted the environment, adulterated their products, and committed fraud—all in the name of profit. In most of the developed world, those days are long gone. Government regulation is one reason for this, and another is the movement for corporate social responsibility (CSR).

Millions of people are now better informed than ever about both the good and the bad things that corporations can do. Newspapers, magazines, television, radio, and the Internet investigate and publicize episodes of business wrongdoing. Many customers will avoid patronizing companies that harm society. As a result, most corporations are eager to create a positive image. And this has given a strong push to CSR.

CSR takes two basic forms. One, which might be called "weak CSR," has the credo: *Do no harm to people or the planet (unless that means sacrificing profit)*. Companies that practice weak CSR are supposed to avoid selling defective goods, dumping factory wastes into rivers or landfills, or bribing government officials.

The second form, "strong CSR," says: *Do good for people and the planet (as long as you can do so without sacrificing profit)*. Companies that practice strong CSR actively seek out opportunities to benefit others as they do business. For example, they may work to develop green products and practices, provide educational opportunities and health plans for their employees, and support initiatives to bring transparency and fairness to government regulation of business.

Is CSR a force that is leading to positive change among business leaders? Could it be that CSR is the mechanism we have been searching for, the tool with which at least some of the problems of society can be fixed?

Unfortunately, the answer is no. There are several reasons why.

The concept of socially responsible business is built on good intentions. But some corporate leaders misuse the concept to produce selfish benefits for their companies. Their philosophy seems to be: Make as much money as you can, even if you exploit the poor to do so—but then donate a tiny portion of the profits for social causes or create a foundation to do things that will promote your business interest. And then be sure to publicize how generous you are!

For companies like these, CSR will always be mere window dressing. In some cases, the same company that devotes a penny to CSR spends 99 cents on moneymaking projects that make social problems *worse*. This is not a formula for improving society!

There are a few companies whose leaders are sincerely interested in social change. Their numbers are growing, as a younger generation of managers rises to the top. Today's young executives, raised on television and the Internet, are more aware of social problems and more attuned to global concerns than any previous generation. They care about issues like climate change, child labor, the spread of AIDS, the rights of women, and world poverty. As these young people become corporate vice presidents, presidents, and CEOs, they bring these concerns into the boardroom. These new leaders are trying to make CSR into a core part of their business philosophy.

This is a well-intended effort. But it runs up against a basic problem. Corporate managers are responsible to those who own the businesses they run—either private owners or shareholders who invest through the stock market. In either case, those owners have only one objective: *To see the monetary value of their investment grow*. Thus, the managers who report to them must strive for one result: *To increase the value of the company*. And the only way to achieve this is by increasing the company's profits. In feet, maximizing profit is their legal obligation to their shareholders unless the shareholders mandate otherwise.

Companies that profess a belief in CSR always do so with this proviso, spoken or unspoken. In effect, they are saying, "We will do the socially responsible thing—so long as it doesn't prevent us from making the largest possible profit." Some proponents of CSR say that pursuit of profit and social responsibility need not be in conflict. Sometimes this is true. Occasionally, through a happy accident, the needs of society and opportunities for high profits happen to coincide.

But what happens when profit and CSR do *not* go together? What about when the demands of the marketplace and the long-term interests of society conflict? What will companies do? Experience shows that profit always wins out. Since the managers of a business are responsible to the owners or shareholders, they *must* give profit the highest priority. If they were to accept reduced profits to promote social welfare, the owners would have reason to feel cheated and consider corporate social responsibility as corporate financial *irresponsibility*.

Thus, although advocates of CSR like to talk about the "triple bottom line" of financial, social, and environmental benefits by which companies should be measured, ultimately only one bottom line calls the shots: financial profit.

Throughout the 1990s and into the new century, American auto companies have produced gas-guzzling, super-sized SUVs, which demand enormous resources to manufacture, use huge amounts of fuel, and create terrible pollution. But they are very popular—and very profitable—and car makers continue to build and sell them by the millions. SUVs are bad for society, for the environment, and for the world, but the big auto companies' primary goal is to make profits, so they keep on doing something very socially irresponsible.

This example illustrates the most fundamental problem with CSR. By their nature, corporations are not equipped to deal with social problems. It's not because business executives are selfish, greedy, or bad. The problem lies with the very nature of business. Even more profoundly, it lies with the concept of business that is at the center of capitalism.

Capitalism Is a Half-Developed Structure

Capitalism takes a narrow view of human nature, assuming that people are one-dimensional beings concerned only with the pursuit of maximum profit. The concept of the free market, as generally understood, is based on this one-dimensional human being.

Mainstream free-market theory postulates that you are contributing to the society and the world in the best possible manner if you just concentrate on getting the most for yourself. When believers in this theory see gloomy news on television, they should begin to wonder whether the pursuit of profit is a cure-all, but they usually dismiss their doubts, blaming all the bad things in the world on "market failures." They have trained their minds to believe that well-functioning markets simply cannot produce unpleasant results.

I think things are going wrong not because of "market failures." The problem is much deeper than that. Mainstream free-market theory suffers from a "conceptualization failure," a failure to capture the essence of what it is to be human.

In the conventional theory of business, we've created a one-dimensional human being to play the role of business leader, the so-called entrepreneur. We've insulated him from the rest of life, the religious, emotional, political, and social. He is dedicated to one mission only—maximize profit. He is supported by other one-dimensional human beings who give him their investment money to achieve that mission. To quote Oscar Wilde, they know the price of everything and the value of nothing.

Our economic theory has created a one-dimensional world peopled by those who devote themselves to the game of free-market competition, in which victory is measured purely by profit. And since we are persuaded by the theory that the pursuit of profit is the best way to bring happiness to humankind, we enthusiastically imitate the theory, striving to transform ourselves into one-dimensional human beings. Instead of theory imitating reality, we force reality to imitate theory.

And today's world is so mesmerized by the success of capitalism it does not dare doubt that system's underlying economic theory.

Yet the reality is very different from the theory. People are not one-dimensional entities; they are excitingly multi-dimensional. Their emotions, beliefs, priorities, and behavior patterns can best be compared to the millions of shades we can produce from the three primary colors. Even the most famous capitalists share a wide range of interests and drives, which is why tycoons from Andrew Carnegie and the Rockefellers to Bill Gates have ultimately turned away from the game of profit to focus on higher objectives.

The presence of our multi-dimensional personalities means that not every business should be bound to serve the single objective of profit maximization.

And this is where the new concept of social business comes in.

2. Social Business: What It Is and What It Is Not

To make the structure of capitalism complete, we need to introduce another kind of business—one that recognizes the multidimensional nature of human beings. If we describe our existing companies as profit-maximizing businesses (PMBs), the new kind of business might be called social business. Entrepreneurs will set up social businesses not to achieve limited personal gain but to pursue specific social goals.

To free-market fundamentalists, this might seem blasphemous. The idea of a business with objectives other than profit has no place in their existing theology of capitalism. Yet surely no harm will be done to the free market if not all businesses are PMBs. Surely capitalism is amenable to improvements. And surely the stakes are too high to go on the way we have been going. By insisting that all businesses, by definition, must necessarily be PMBs and by treating this as some kind of axiomatic truth, we have created a world that ignores the multidimensional nature of human beings. As a result, businesses remain incapable of addressing many of our most pressing social problems.

We need to recognize the real human being and his or her multi-faceted desires. In order to do that, we need a new type of business that pursues goals other than making personal profit—a business that is totally dedicated to solving social and environmental problems.

In its organizational structure, this new business is basically the same as the existing PMB. But it differs in its objectives. Like other businesses, it employs workers, creates goods or services, and provides these to customers for a price consistent with its objective. But its underlying objective—and the criterion by which it should be evaluated—is to create social benefits for those whose lives it touches. The company itself may earn a profit, but the investors who support it do not take any profits out of the company except recouping an amount equivalent to their original investment over a period of time. A social business is a company that is cause-driven rather than profit-driven, with the potential to act as a change agent for the world.

A social business is not a charity. It is a business in every sense. It has to recover its full costs while achieving its social objective. When you are running a business, you think differently and work differently than when you are running a charity. And this makes all the difference in defining social business and its impact on society.

There are many organizations in the world today that concentrate on creating social benefit. Most do *not* recover their total costs. Nonprofit organizations and nongovernmental organizations rely on charitable donations, foundation grants, or government support to implement their programs. Most of their leaders are dedicated people doing commendable work. But since they do not recover their costs from their operations, they are forced to devote part of their time and energy, sometimes a significant part, to raising money.

A social business is different. Operated in accordance with management principles just like a traditional PMB, a social business aims for full cost recovery, or more, even as it concentrates on creating products or services that provide a social benefit. It pursues this goal by charging a price or fee for the products or services it creates.

How can the products or services sold by a social business provide a social benefit? There are countless ways. For a few examples, imagine:

- A social business that manufactures and sells high-quality, nutritious food products at very low prices to a targeted market of poor and underfed children. These products can be cheaper because they do not compete in the luxury market and therefore don't require costly packaging or advertising, and because the company that sells them is not compelled to maximize its profit.
- A social business that designs and markets health insurance policies that provide affordable medical care to the poor.
- A social business that develops renewable-energy systems and sells them at reasonable prices to rural communities that otherwise can't afford access to energy.
- A social business that recycles garbage, sewage, and other waste products that would otherwise generate pollution in poor or politically powerless neighborhoods.

In each of these cases, and in the many other kinds of social businesses that could be imagined, the company is providing a product or service that generates sales revenue even as it benefits the poor or society at large.

A social-objective-driven project that charges a price or fee for its products or services but cannot cover its costs fully does not qualify as a social business. As long as it has to rely on subsidies and donations to cover its losses, such an organization remains in the category of a charity. But once such a project achieves full cost recovery, on a sustained basis, it graduates into another world—the world of business. Only then can it be called a social business.

The achievement of full cost recovery is a moment worth celebrating. Once a social-objective-driven project overcomes the gravitational force of financial dependence, it is ready for space flight. Such a project is self-sustaining and enjoys the potential for almost unlimited growth and expansion. And as the social business grows, so do the benefits it provides to society.

Thus, a social business is designed and operated as a business enterprise, with products, services, customers, markets, expenses, and revenues—but with the profit-maximization principle replaced by the social-benefit principle. Rather than seeking to amass the highest possible level of financial profit to be enjoyed by the investors, the social business seeks to achieve a social objective.

Social Business Profits Stay within the Business

A social business differs from a charity or an NGO or a nonprofit group in another important way. Unlike those organizations, but like a traditional PMB, a social business has owners who are entitled to recoup their investments. It may be owned by one or more individuals, either as a sole proprietorship or a partnership, or by one or more investors, who pool their money to fund the social business and hire professional managers to run it. It may be also owned by government or a charity, or any combination of different kinds of owners.

Like any business, a social business cannot incur losses indefinitely. But any profit it earns does not go to those who invest in it. Thus, a social business might be defined as a *non-loss, non-dividend business.* Rather than being passed on to investors, the surplus generated by the social business is reinvested in the business. Ultimately, it is passed on to the target group of beneficiaries in such forms as lower prices, better service, and greater accessibility.

Profitability is important to a social business. Wherever possible, without compromising the social objective, social businesses should make profit for two reasons: First, to pay back its investors; and second, to support the pursuit of long-term social goals.

Like a traditional PMB, a social business needs to have a long-term road map. Generating a surplus enables the social business to expand its horizons in many ways—by moving into new geographic areas, improving the range or quality of goods or services offered, mounting research and development efforts, increasing process efficiencies, introducing new technologies, or making innovations in marketing or service delivery so as to reach deeper layers of low-income people.

However, the bottom line for the social business is to operate without incurring losses while serving the people and the planet—and in particular those among us who are most disadvantaged—in the best possible manner.

How long will it take for investors to get back their investment in a social business? That is up to the management of the social business and the investors themselves. The proposed payback period would be specified in the investment prospectus: It might be five years, ten, or twenty. Investors could choose the appropriate social business in which to invest partly on the basis of this time frame and on their own anticipated needs, as well as their preference for a particular social objective.

Once the initial investment funds are recouped, investors can decide what to do with those funds. They might reinvest in the same social business, invest in another social business or a PMB, or use the money for personal purposes. In any case, they remain as much owners of the social business as before, and have as much control over the company as before.

Why would investors put their money into a social business? Generally speaking, people will invest in a social business for the same kind of personal satisfaction that they can get from philanthropy. The satisfaction may be even greater, since the company they have created will continue to work for the intended social benefit for more and more people without ever stopping. The many billions of dollars that people around the world donate to charitable causes every year demonstrate that they have a hunger to give money in a way that will benefit other human beings. But investing in a social business has several enormous differences from philanthropy.

First, the business one creates with social business is self-sustaining. There is no need to pump in money every year. It is self-propelling, self-perpetuating, and self-expanding. Once it is set up, it continues to grow on its own. You get more social benefits for your money.

Second, investors in a social business get their money back. They can reinvest in the same or a different social business. This way, the same money can bring more social benefits.

Since it is a business, businesspeople will find this as an exciting opportunity not only to bring money to social business but to leverage their own business skills and creativity to solve social problems. Not only does the investor get his money back, he still remains an owner of the company and decides its future course of action. That's a very exciting prospect on its own.

Broadening the Landscape of Business

With the entry of social businesses, the marketplace suddenly finds itself with some new and exciting options, and becomes a more interesting, engaging, and competitive place. Social concerns enter the marketplace on an equal footing, not through the public relations window.
Social businesses will operate in the same marketplace with PMBs. They will compete with them, try to outmaneuver them, and seek to capture market share from them, just as other businesses do. If a social business is offering a particular product or service that is also

available from a PMB, consumers will decide where to buy, just as they now choose among competing PMBs. They will consider price, quality, convenience, availability, brand image, and all the other traditional factors that influence consumer choices today.

Perhaps for some consumers, the social benefits created by the social business will be an additional reason to buy from it—just as some consumers today prefer to patronize companies with a reputation for being worker-friendly, environmentally conscious, or socially responsible. But for the most part, social businesses will compete with PMBs on the same terms as we see in traditional capitalist competition—and may the best company win.

Social businesses will also compete with one another. If two or more social businesses are operating in the same market, consumers will have to decide which one to patronize. Again, product and service quality will probably be the main determining factor for most customers.

Social businesses will also compete for potential investors, just as PMBs do. Of course, this will be a different kind of competition than we see among PMBs.

Consider two profit-maximizing businesses that are competing for investment dollars—two auto makers, for example. The competition here will turn on which PMB is perceived as having a greater future profit potential. If most investors believe that company A is likely to be more profitable than company B, they will rush to buy shares of company A stock, because they expect to earn higher dividends in the future, and they also expect to benefit from continuing growth in the overall value (or *equity*) of the company. This launches a positive cycle in which company A stock rises in price, making investors happy.

By contrast, when two social businesses compete for investors, the competition is based not on future profit maximization but on social benefits achieved. Each social business will claim that it is better positioned to serve the people and the planet than its rival, and it will develop and publicize a business plan to support that claim. Would-be social investors will scrutinize those claims carefully. After all, they are planning to invest their money with the goal of benefiting society, and they will want to be sure that their investment does the greatest possible good. Just as a profit-minded investor seeks to maximize expectations of future dividends and equity growth, a social investor wants to find out how close the company is getting in solving the social problem it is addressing.

Thus, competing social businesses will push each other to improve their efficiency and to serve the people and the planet better. This is one of the great powers of the social-business concept: It brings the advantages of free-market competition into the world of social improvement.

Competition in the marketplace of ideas almost always has a powerful positive impact. When a large number of people are vying to do the best possible job of developing and refining an idea—and when the flow of money toward them and their company depends on the outcome of the competition—the overall level of everyone's performance rises dramatically. We see this beneficial effect of competition in many arenas. Intense competition among makers of personal computers, for example, has caused the price of PCs to fall dramatically even as their speed, power, and other features have improved. The rise of Japanese manufacturers of cars and electronic products forced U.S. and European companies to improve the quality of their goods so as to compete for both customers and investors.

By creating a competitive marketplace for social-benefit investing, the concept of social business brings the same kind of positive pressure to bear among those who seek to serve the disadvantaged people of the world.

Competition among social businesses will be different in quality than competition among PMBs. PMB competition is about making more money. If you lose, you get financially hurt. Social business competition will be about pride, about establishing which team is best able to achieve the social objective. Competitors will remain friends. They will learn from each other. They can merge with each other at any time to become a stronger social force. And they will feel happy to see another social business entering the same area of business, rather than getting worried.

To attract investors, I propose the creation of a separate stock market, which could be called the social stock market. Only social businesses will be listed there. (See chapter 8 for a detailed description of this concept.) The existence of a public marketplace for trading shares in social businesses will have many benefits. It will create liquidity, making it easy for shareholders to move in and out of social investments, just as they currently do with investments in PMBs. It will generate public scrutiny and evaluation of social businesses, providing a layer of "natural regulation" to supplement any government regulation that will need to be created to avoid the usual problems of the marketplace: deception, false reporting, inflated claims, disguised businesses, and so on. And it will raise the public profile of the social-business concept, attracting even more money and energy from investors and entrepreneurs alike.

Two Kinds of Social Businesses

At this stage in the development of the concept of social business, we can only glimpse its general outlines. In the years to come, as social businesses begin to spring up around the world, new features and forms of social business will undoubtedly be developed. But from today's vantage point, I propose two possible kinds of social businesses.

The first I have already described: Companies that focus on providing a social benefit rather than on maximizing profit for the owners, and that are owned by investors who seek social benefits such as poverty reduction, health care for the poor, social justice, global sustainability, and so on, seeking psychological, emotional, and spiritual satisfactions rather than financial reward.

The second operates in a rather different fashion: Profit-maximizing businesses that are owned by the poor or disadvantaged. In this case, the social benefit is derived from the fact that the dividends and equity growth produced by the PMB will go to benefit the poor, thereby helping them to reduce their poverty or even escape it altogether.

Notice the differences between these two kinds of social businesses. In the first case, it is the nature of the products, services, or operating systems of the business that creates the social benefit. This kind of social business might provide food, housing, health care, education, or other worthwhile goods to help the poor; it might clean up the environment, reduce social inequities, or work to alleviate ills such as drug and alcohol abuse, domestic violence, unemployment, or crime. Any business that can achieve objectives like these while covering its costs through the sales of goods or services and that pays no financial dividend to its investors can be classified as a social business.

With the second type of social business, goods or services produced might or might not create a social benefit. The social benefit created by this kind of company comes from its ownership. Because the ownership of shares of the business belongs to the poor or disadvantaged (as defined by specific, transparent criteria developed and enforced by the company directors), any financial benefit generated by the company's operations will go to help those in need.

Imagine that a poor rural region of a country is separated from the main commercial centers by a river too deep, wide, and wild to be forded by pedestrians or ordinary vehicles. The only way to cross this river is by ferry, which provides expensive, slow, and intermittent service. As a result, the area's poor and low-income residents face economic and social handicaps that depress their incomes, reduce availability of affordable goods, and lower their access to education, health care, and other vital services. In our example, we assume that the national and local governments are unable to address the problem because of lack of funds, political indifference, or other shortcomings. (Although this is a hypothetical example, it accurately describes conditions in much of the developing world.)

Now suppose a private company is formed to build a new highway and a safe, modern bridge to connect the rural area with the commercial center of the country. This company could be structured as a social business in two ways.

First, it could provide access to poor and low-income residents at a discounted toll, while charging a commercial toll to middle- and upper-class residents and to large commercial organizations. (Obviously some kind of means-testing procedure would be needed to verify the eligibility of poor people for the discounted toll; perhaps the same kind of ID card that is used to indicate eligibility for government welfare could be accepted by the toll-takers.) The toll revenues would cover the costs of building, operating, and maintaining the bridge and highway, and, over time, they could be used to repay the funds initially provided by investors. However, those investors would receive no further profits. If profits beyond this are generated by the tolls, they could be used to build additional infrastructure to benefit the rural community—more roads and bridges, for example, or perhaps some social businesses to stimulate the local economy and create jobs.
Second, ownership of the bridge-and-highway company could actually be put in the hands of the poor and lower-income residents of the rural area. This could be done through the sale of low-priced shares, purchased by them with loans provided by microcredit organizations or through credit that is later recouped from the profit of the company. Further profits generated by tolls could *either* be invested in new infrastructure projects or paid in the form of dividends

to the poor and lower-income residents who own the company, thereby benefiting them in direct financial fashion.

Grameen Bank makes small loans available without collateral and at a reasonable cost to the poor, thereby enabling them to start or expand tiny businesses and ultimately lift themselves out of poverty. Grameen Bank would be a regular PMB if it were owned by well-off investors. But it is not. Grameen Bank is owned by the poor: Ninety-four percent of the ownership shares of the institution are held by the borrowers themselves.

Thus, Grameen Bank is a social business by virtue of its ownership structure. If a big bank like Grameen can be owned by poor women in Bangladesh, any big company can be owned by poor people, if we seriously come up with practical ownership-management models.

And yes, a social business could also combine *both* forms of benefit to the poor: It could follow a business plan designed to produce social benefits through the nature of the goods and services it creates and sells *and also* be owned by the poor or disadvantaged.

The Difference between Social Business and Social Entrepreneurship

Some people are puzzled when they hear about social business for the first time. Most often, social business is equated with *social entrepreneurship*. My friend Bill Drayton has built a global movement around the concept of social entrepreneurship through his Ashoka Foundation.

Decades ago, Bill became convinced that creative, innovative thinking could be applied to solve seemingly intractable social problems. He was excited to see that many people around the world are doing just that, some of them without even realizing that they fall into a very special group of people. One of the first initiatives Bill undertook was to find these people and to give them recognition by calling them Ashoka Fellows. Then he upgraded his initiatives by organizing conferences, meetings, and workshops to bring social entrepreneurs together, helping them learn from each other, supporting them with small grants, introducing them to donors, documenting their activities, and producing videos that portrayed their work and philosophies.

Today, social entrepreneurship has become a recognized movement. Besides Ashoka, there are several other foundations dedicated to promoting social entrepreneurship, including the Skoll Foundation, founded by Jeff Skoll (the first employee and CEO of eBay), and the Schwab Foundation for Social Entrepreneurship, founded by Klaus Schwab (the founder of the World Economic Forum). They have made it their mission to find, support, and encourage social entrepreneurs around the world.
Social entrepreneurship has become a popular concept among both business people and the general public. The American business magazine *Fast Company* publishes a list of the twenty-five best social entrepreneurs every year, bringing attention and funding to some of today's most effective social service organizations. Social entrepreneurship has even become an academic discipline, having found its way into the curricula of some thirty U.S. business

schools since the first course in the subject was offered at Harvard in 1995 by Dr. J. Gregory Dees, now at Duke University's Fuqua School of Business.

The concept of social entrepreneurship is very important. It brings out the power of yearning in people to do something about problems that are not currently being addressed with the efficiency and urgency they deserve. Because of the movement built around this concept today, we can see an enormous range of people around the world doing exciting things to help others. Grameen Bank and the Grameen sister organizations are often cited as being significant symbols of this movement.

But social business and social entrepreneurship are not the same thing. Social entrepreneurship is a very broad idea. As it is generally defined, any innovative initiative to help people may be described as social entrepreneurship. The initiative may be economic or non-economic, for-profit or not-for-profit. Distributing free medicine to the sick can be an example of social entrepreneurship. So can setting up a for-profit health-care center in a village where no health facility exists. And so can launching a social business.

In other words, social business is a subset of social entrepreneurship. All those who design and run social businesses are social entrepreneurs. But not all social entrepreneurs are engaged in social businesses.

Until very recently, the movement around social entrepreneurship has not showcased the issue of social business because that concept did not exist. Now that the concept has been introduced and is being translated into reality, I am sure that many in the social-entrepreneurship movement will be attracted to it.

The social-entrepreneurship movement can start giving special attention to the creation and promotion of social businesses by devising and sharpening appropriate tools and institutional facilities needed to support this new type of enterprise. Some social entrepreneurs may be encouraged to move in the direction of social business because they can achieve much more in terms of social benefits than is possible through traditional structures.

What about a "Hybrid"?

Some of those who learn about social business wonder whether a hybrid version—combining characteristics of a PMB with those of a social business—is possible.

PMBs are driven by the profit motive—that is, the desire for personal gain. Social business is driven by the desire to do good for people and the planet—that is, selfless concern for others. Can there be a business that mixes both, including some elements of self-interest and some elements of selflessness?

Of course, this can happen—it can happen in limitless ways. One can imagine a business driven by, say, 60 percent social-benefit objectives and 40 percent personal-benefit objectives, or the other way around. There can be innumerable such combinations.

But in the real world, it will be very difficult to operate businesses with the two conflicting goals of profit maximization and social benefits. The executives of these hybrid businesses will gradually inch toward the profit-maximization goal, no matter how the company's mission is designed. For example, suppose we instruct the CEO of a food company to "maximize profit *and* make sure that poor children benefit nutritionally by providing them with high-quality meals at the lowest possible price." The CEO will be confused as to which part of the instruction is the real instruction. How will his success be judged—on the basis of the money he earns for the investors or on the basis of the social goals he achieves?

Making matters worse, the existing business environment is exclusively focused on profit maximization. All current tools of business are related to judging whether or not a business is maximizing profit. Accounting practices and standards are clearly established for that purpose; profit can be measured in precise financial terms. But measuring the achievement of social objectives has conceptual complications. If the goal is to improve the nutrition of poor children, who exactly is "poor"? What biological standards will be used to measure their nutritional status before and after? How reliable will the information be? These are difficult questions to answer precisely. Furthermore, since social problems are inherently complex, information related to social goals would generally suffer from a greater time kg than profitability data.

For all these reasons, our CEO will find it much easier to run the company basically as a PMB and be judged in the company of other PMBs. And so, it is more realistic to think in terms of two pure models: the profit-maximizing model and the social-business model.

One big advantage of pure models is that it is difficult to add gimmicks to them to create a false impression in people’s minds. If you are a social business, you are a social business, and investors will not expect any return from your revenues. But if you are a profit-maximizing company, you are in the business of making money, and no one will be deceived into thinking that you are in business for social reasons.

Past Attempts to Combine Social Goals with Traditional Business

Social business is not just a theoretical concept. There are social businesses around the world, including the Grameen Bank and such Grameen-affiliated companies as Grameen Danone. Other fledgling social businesses are beginning to pop up, embodying the potential for social good and economic development latent in this new form of business.

Social businesses can become powerful players in the national and international economy, but we have a long way to go to achieve that goal. Today the assets of all the social businesses of the world wouldn't add up to even an ultra-thin slice of the global economy. It is not because they lack growth potential, but because conceptually people neither recognize their existence nor make any room for them in the market. They are considered freaks and are kept outside the mainstream economy. People do not pay attention to them—in fact, they literally *cannot see them*—because their eyes are blinded by the theories taught in our schools. Once we recognize social business as a valid economic structure, supportive institutions, policies, regulations, norms, and rules will come into being to help it become mainstream.

Over the past three centuries, since modern capitalism began its ascent to world dominance, many people around the world have recognized the shortcomings of the current, incomplete form of capitalism. They have experimented with various ways of remedying the problem. However, the full structure of social business as I envision it has not emerged, even as a concept, until our time. As a result, none of the existing modes by which people have tried to adapt businesses to serve social goals has been very effective. Only social business offers the full solution for which thousands of people have been searching.

One attempt to bring humane, enlightened thinking into business organizations is the cooperative movement, in which workers and consumers join forces in owning businesses and managing those businesses for the benefit of all.

Robert Owen (1771-1858), a Welshman who owned and operated cotton mills in England and Scotland, is often considered the pioneer of this movement. Owen was appalled by the exploitation of workers in the earliest decades of the industrial revolution. In particular, he deplored the widespread English practice of paying mill workers not in common currency but in scrip that could be used only in company-owned stores, which, in turn, charged inflated prices for shoddy goods.

This vicious cycle of oppression was reminiscent of the near-enslavement of poor Bangladeshis by moneylenders that I discovered in Jobra when I first began the work that led to the founding of Grameen Bank. It also recalls the exploitation of sharecroppers in the American South by landowners who used the indebtedness of their farm laborers to force them into doing business with overpriced company stores, creating a closed economic loop in which capital flowed only into the pockets of the owners and never went to benefit the working people.

Owen took practical steps to deal with this problem. At his own mills in New Lanark, Scotland, he opened stores where high-quality goods were sold at prices just above cost, with the savings from bulk purchases passed on to his employees. This was the germ from which the cooperative movement sprang. This movement is built around the concept of having businesses owned by their customers and operated primarily for the benefit of those customers rather than to generate profits for merchants. Shops that are operated on Owen's plan are common to this day throughout Britain and elsewhere in Europe.

The cooperative movement began as a response to the exploitation of the poor by rapacious company owners. However, the cooperative concept is not inherently oriented toward helping the poor or producing any other specific social benefit. Depending on the goals and interests of the people who band together to create and share ownership of a cooperative business, such a business can be structured to benefit the middle class as well as those who are needy. If they fall into selfish hands, cooperatives can even become a means for controlling the economy for purposes of individual or group gain rather than to help everyone in society. When a cooperative business loses sight of its original social objectives, it becomes, in practice, a profit-maximizing company almost the same as any other.

Another way in which some people have tried to combine the dynamism and self-sufficiency of business with the pursuit of worthy social goals has been through the creation of nonprofit organizations that sell socially beneficial products and services. These companies are not true social businesses as I define them. They generally achieve only partial cost recovery, which means that they do not attain the "lift-off velocity" that would enable them to escape the gravitational pull of dependence on charity. Also, they do not have the investor-owner feature that distinguishes social business, creating a source of funds with an interest in ensuring both the efficiency and effectiveness of the social benefits generated by the business.

There have also been attempts by managers of traditional PMBs to manage companies in a socially responsible fashion. That includes the occasional launch of a PMB that offers some social benefits alongside the pursuit of profit. Corporations may take this step for any number of reasons:

- To support the personal goals or values of a powerful or respected corporate leader
- To earn favorable publicity for the company, or to deflect criticism over past ethical and business lapses
- To attract customers who may prefer to do business with a company they perceive as "good guys"
- To win the friendship and support of government regulators or legislators who are considering laws that might affect the company
- To reduce opposition from community organizations or public-interest groups that might otherwise try to block company plans for expansion
- To gain a foothold in a new market that holds promise for the future but is currently unprofitable—while also earning points in the court of public opinion

It can be difficult to tell, in a particular instance, what combination of motives drives a particular company decision. In some cases, even the company executives may not be able to accurately describe the precise blend of motives that impel them. However, because they are PMBs, these businesses will ultimately be subject to the same financial pressures as all other for-profit companies. And this means that any social goals their managers may want to pursue will be set aside whenever they conflict with the maximization of profit.

In the end, none of the organizational structures I've described here—the cooperative, the nonprofit enterprise, or the socially responsible PMB—offers the powerful advantages of the true social business. This is why the world is crying out for this new way of doing business.

When the social-business concept becomes well known and begins to spread through all the free-market economies of the world, the flood of creativity that this new business channel will unleash has the potential to transform our world.

Where Will Social Businesses Come From?

Because the concept of social business is still new and unfamiliar, it may seem difficult at first to imagine who will create such businesses and why. Everyone is familiar with traditional entrepreneurs, and whether or not we admire them, we feel that we understand their values and motivations. The same is not true for the founders of the social business.

I think, given the opportunity, every human being is a potential participant in a social business. The motivating forces behind social business are packed inside each human being, and we see bits and pieces of these forces every day. People care about their world, and they care about one another. Humans have an instinctive, natural desire to make life better for their fellow humans if they can; given the chance, people would prefer to live in a world without poverty, disease, ignorance, and needless suffering. These are the causes that lead people to donate billions of dollars to charity, to create foundations, to launch NGOs and nonprofit organizations, to volunteer countless hours to community service, and (in some cases) to devote their careers to relatively low-paid work in the social sector. These same drives will lead many to create social businesses, once this new path is widely recognized and understood.

To begin with, here are some of the specific sources from which the social businesses of the future might spring:

- Existing companies of all shapes and sizes will want to launch their own social businesses. Some will choose to devote part of their annual profit to social business as part of their existing "social responsibility" mandates. Others will create social businesses as a way of exploring new markets while helping the less fortunate. They may create social businesses on their own, with the help of other companies, or in partnership with specialized social-business entrepreneurs.
- Foundations may create social-business investment funds, operating parallel to but separate from their traditional philanthropic windows. The advantage of a social-business fund is that its money will not be exhausted even as it works to produce social benefits, continually replenishing the foundation’s ability to support good works.
- Individual entrepreneurs who have experienced success in the realm of PMBs may choose to test their creativity, talent, and management skills by establishing and running social businesses. They may be driven by the desire to give something back to the communities that have enriched them, or simply by the urge to try something new. Those who enjoy success in their first experiments may become "serial social-business entrepreneurs," creating one social business after another.
- International and bilateral development donors, ranging from national aid programs to the World Bank and the regional development banks, may choose to create dedicated funds to support social-business initiatives in the recipient countries, or at international, or regional, or institutional levels. The World Bank and regional development banks can create subsidiaries to support social businesses.
- Governments may create social-business development funds to support and encourage social businesses.

- Retired persons with wealth to spare will find social businesses an attractive investment opportunity to pursue. Similarly, inheritors of wealth or recipients of windfall gains may be inspired to think of launching or investing in social businesses.
- Young people fresh out of college or business school may choose to launch social businesses rather than traditional PMBs, motivated by the idealism of youth and the excitement of having the opportunity to change the world.

Young people all around the world, particularly in rich countries, will find the concept of social business very appealing. Many young people today feel frustrated because they cannot recognize any worthy challenge that excites them within the present capitalist system. When you have grown up with ready access to the consumer goods of the world, earning a lot of money isn't a particularly inspiring goal. Social business can fill this void.

With so many potential sources, I predict that, within a few years, social businesses will be a familiar fixture on the world business scene.

Human Beings Are Multi-Dimensional

We might enrich the economists' narrow-minded view of society by assuming a world in which there are two kinds of people—one that wants to maximize profits and one that wants to create social benefits and do good things for people and the planet. But even with this new assumption, we still remain in a world of one-dimensional people—only two kinds of one-dimensional people, instead of the single kind imagined by classical economics.

In the real world, there are not two types of one-dimensional people. Instead, there is only one type of person: people with two, three, four, or *many* interests and goals, which they pursue with varying and ever-changing degrees of interest. For the sake of simplicity, we can divide these interests into two broad categories—profit and social benefit—which correspond to the two types of businesses we've described in this chapter: traditional PMBs and social businesses.

How will individuals, companies, and investors choose which of these two paths to follow? The beautiful thing is that people will not be faced with an absolute, either/or choice. In most cases, they will have the opportunity to participate in both PMBs and social businesses in varying proportions, depending on the goals and objectives they most value at a particular moment in time. For example:

- An individual with a nest egg to invest might choose to invest part in PMBs (with the goal, for example, of creating a retirement fund) and the rest in social businesses (in order to help society, humanity, and the planet).
- The board of directors of a PMB might decide to use part of one year's surplus to buy out another company in order to expand their business into a new market—and use the rest of the surplus to launch a social business or to invest in an existing one, as an alternative to traditional philanthropy or corporate charity.

- The trustees of a foundation might choose to use part of its endowment income to fund one or more social businesses whose objectives coincide with the goals specified by the foundation's donors.
- Even when it comes to making career or life choices, social businesses will only increase the possibilities we enjoy rather than foreclosing any of them. The same person might choose to work for part of his or her life for a PMB; another part for a traditional charity, foundation, or NGO; and still another part for a social business. The choice will depend on how the individual's career interests, goals, and social concerns vary and evolve over time.

There is no reason why we need to feel constrained, in either our investment choices or our life decisions, to follow a single, one-dimensional model of human behavior. We humans are multi-dimensional creatures, and the business models we recognize should be equally diverse. Recognizing and encouraging social business as an option will help make this possible.

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[1] There are almost as many definitions of poverty as there are individuals and groups studying the problem. A recent World Bank study mentions thirty-three different poverty lines developed and used by particular countries in addressing the needs of their own poor people. Earlier in this chapter, I mentioned the widely used poverty benchmark of an income equivalent to one dollar a day or less. In the remainder of this book, whenever I refer to "poverty" with no more specific explanation, this dollar-a-day definition may be assumed.

THE NEXT 4 BILLION — THE HOUSING MARKET

Allen Hammond, William J. Kramer, Rob Katz, Julia Tran, Courtland Walker

Housing is one of the larger base of the pyramid (BOP) markets—larger than transportation, smaller than energy. The market encompasses major spending items—rent, mortgage payments (or imputed rents), and repairs and other services. But the BOP housing market is perhaps uniquely handicapped by informality. Both lack of legal title to housing in squatter settlements—Hernando De Soto's "dead capital"—and lack of access to mortgage financing for the BOP limit its potential size.

Despite these barriers, both private sector approaches and policy reforms—sometimes catalyzed by NGOs—are showing how to tap this market in ways that provide significant benefits for BOP households. In Asia especially, where mortgage markets are undeveloped and land prices high relative to income, the market potential—and the need—is huge (Bestani and Klein 2006).

How large is the market?

The measured BOP market for housing in Africa (12 countries), Asia (9), Eastern Europe (6), and Latin America and the Caribbean (9) is $187.5 billion. This represents recorded annual household spending on housing in the 36 low- and middle-income countries for which standardized data exist, covering 2.1 billion of the world's BOP population. The total BOP housing market in these four regions, including 3.96 billion people in all surveyed countries, is estimated to be $331.8 billion. Because imputed rent is a major part of household spending on housing and cannot be determined precisely, these numbers should be regarded as setting a lower bound for such spending.

Asia has the largest measured regional BOP market for housing, $86.6 billion, reflecting a significant BOP population of 1.49 billion. The total BOP housing market in Asia (including the Middle East) is estimated to be $171.4 billion, representing the spending of 2.9 billion people. Latin America has the next largest measured market, $47.4 billion (276 million people), and an estimated total market of $56.7 billion (360 million people).

In Eastern Europe the measured BOP housing market is $34.2 billion (148 million people), and the estimated total market $60.8 billion (254 million people). In Africa the measured BOP market is $19.3 billion (258 million people), and the estimated total BOP market is $42.9 billion (486 million people).

The average BOP share of measured national housing markets varies across regions. In Asia and Africa that share is 63%. In other regions it is much smaller: 39% in Latin America, 35% in Eastern Europe. Latin America has the greatest disparity between the BOP share of the population (71%) and the average BOP share of housing spending (39%).

The BOP share of housing spending also varies across countries. These differences in part reflect the prevalence of a landed middle class in some developing countries, such as South Africa and throughout Latin America. Between mid-market landowners and disenfranchised BOP communities, the BOP share of a country's housing market is on average half that of its weight in population. Nonetheless, in countries such as Pakistan and Sierra Leone, the BOP accounts for more than 95% of the measured housing market.

In Asia one extreme is represented by Sri Lanka, Pakistan, and Bangladesh, where the BOP accounts for more than 90% of the spending on housing—the other by Thailand and India, where despite the substantial BOP population, the recorded BOP share is only 47% and 48%, respectively. In Africa the extremes are Nigeria (99% BOP) and South Africa (31%). In Eastern Europe the extremes are represented by Uzbekistan (92%) and FYR Macedonia (13%).

How is the market segmented?

Many African BOP markets for housing are relatively bottom heavy, with spending concentrated in the bottom three of the six BOP income segments. The remainder are flat, with spending distributed relatively evenly across all BOP income segments. In Asia too, most BOP housing markets are either bottom heavy or flat.

In Eastern Europe, in contrast, almost all countries have a top-heavy BOP market, with the top three segments accounting for more than half of BOP housing spending. The lone exception is Uzbekistan, where the bottom three BOP income segments account for 77% of spending. In Latin America spending tends to flatten out at the BOP1500 segment. In Brazil, for example, the top four segments each account for 19–23% of BOP housing spending.

In Latin America and the Caribbean some large national housing markets are dominated by the wealthier mid-market segment; in Colombia the BOP accounts for only 27% of the total. In Peru, however, the BOP segment accounts for nearly three-quarters of the total market (73%). Jamaica represents the extreme, with 88% of the national housing market in the BOP.

In contrast, the BOP dominates Asian markets, with only Thailand and India having slightly more than half of total housing spending in the mid market. Africa too is predominantly a BOP market: in only one country, South Africa, does spending in the mid-market segment exceed that in the BOP.

What do households spend?

BOP spending on housing reflects consistently strong demand: people are willing to spend a fairly constant share of their income on their home.

India has the largest measured BOP housing market in Asia, $62.1 billion; BOP spending accounts for 48% of the national housing market and averages $164 per household a year. In other regions the BOP market leaders are Mexico ($45.6 billion, 44% of the total market), with average annual spending of $1,280 per BOP household; Russia ($94.7 billion, 34% of the total market), with average spending of $1,268; and South Africa ($14.4 billion, 31% of the total market), with average spending of $652.

These expenditures by BOP households may not be large. But in Mexico they are large enough to fuel two significant and growing corporate efforts to tap BOP housing markets.

Where is the market?

In 24 of the 36 measured countries, BOP housing markets are predominately urban. However, it is often difficult for national surveys to accurately measure housing expenditure in poor rural areas—often rents must be imputed.

In Asian and African countries, housing markets are often predominantly rural. The Ugandan BOP housing market, for example, is 71% rural. Most Asian BOP housing markets also are predominantly rural. In Sri Lanka, for example, 77% of the BOP housing market is rural. Rural housing markets can be substantial—$9 billion in Thailand, for example. An exception to the pattern of rural dominance is Pakistan, where urban squatter settlements account for much of the imputed BOP rent and the BOP housing market is only 36% rural.

In Eastern Europe, where countries were so heavily urbanized under Soviet rule, much of the housing is in cities. In Russia just 19% of the BOP market is rural. Only two countries have BOP markets in which at least a quarter of the spending takes place in rural areas—FYR Macedonia (31%) and Belarus (25%).

In many Latin American countries reported spending on housing also occurs mostly in urban areas. In Colombia, for example, urban spending is 92% of the total for BOP housing. In Guatemala, however, the BOP housing market is 52% rural and 48% urban.

Large urban BOP communities represent huge untapped market opportunities. Mexico's urban BOP housing market is nearly $16 billion annually. Brazil and Colombia each report urban BOP housing spending of more than $8 billion a year.

Is there evidence of a BOP penalty?

Household surveys seek to capture all sources of income, but they do not measure the "dead capital" trapped in the informal economy. For many BOP households, their dwelling and the land it sits on is their primary capital. When they lack formal title to that asset, or when they must contend with ineffective land markets or barriers to transferring title, housing becomes dead capital. Under these circumstances BOP households face a significant BOP penalty—one that artificially curbs their potential purchasing power and often their access to services.

The problem extends to the multitude of enterprises in the informal economy. These businesses, operating outside the formal legal system, cannot easily leverage their assets into working capital. The dead capital trapped in houses and businesses together is enormous: a recent study showed that informal properties and businesses in just 12 Latin American countries are worth as much as US$1.2 trillion (ILD 2006; IDB 2006). Worldwide, the figure is estimated to be at least US$9.3 trillion, and is probably much larger (De Soto 2004).

Informal home ownership also poses a barrier to service delivery. Many governments require proof of title before a household can receive social benefits. And municipalities often are unwilling to connect undocumented homes to water, sewer, and electricity networks, since they have no legal recourse to collect un-paid fees from a home that—in the eyes of the government—does not exist.

Economist Hernando De Soto (2003) has suggested that one way out of this informality trap is to make extralegal ownership more formal—for example, by offering home owners official title to their home. A different strategy, in Pakistan, has focused on providing lowcost mortgages that enable low-income families to buy new homes with secure titles.

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Endnotes

1. Reported household expenditures in a given country should be regarded as a minimum estimate of actual expenditures, because surveys may not have collected information on all types of housing-related spending. Moreover, many surveys do not account for the expenditure value of an owner-occupied dwelling; these surveys are standardized using a rent imputation to estimate the amount of money owners would spend if they were renting the house they own.

2. Many surveys in Latin American countries suffer from measurement and imputation problems in rural areas, which may lead to underrecording of the rural housing market.

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A VALUE CHAIN FRAMEWORK FOR AFFORDABLE HOUSING IN EMERGING COUNTRIES

Bruce Ferguson

Housing the low/moderate-income majority of developing countries creates enormous potential demand for many types of goods and services (World Resources Institute and International Finance Corporation, 2006) – from cement to home credit. However, designing, marketing, and delivering products for this market requires understanding the settlement and shelter problem of low/moderate-income families.

Currently, one-sixth of the world's population – one billion people – live in urban slums in emerging countries. In addition, virtually all net growth of 2.6 billion in world population between now and 2050 is projected to occur in these cities. In effect, relatively poor nations will build the equivalent of a city of more than one million people each week for the next 45 years. Absent major change, the bulk of this new development will occur informally without integration into mainstream markets at tremendous public and private cost. A long history of government slum upgrading, sites and services, and other heavily-subsidized programs offers little hope for dealing with this emergency. While government inevitably plays an important function, new market-based approaches to affordable housing are essential to reach the massive scale commensurate with the enormous demand (Ferguson, 2007).

This issue of *Global Urban Development Magazine* has resulted from a collaboration of this magazine with *Ashoka* – an international organization devoted to social entrepreneurship – to assemble a series of papers that focus on the role of the private sector in meeting the affordable housing and urban development challenge. As a preface to these papers, this introduction presents a framework for analyzing the complex housing problem and the extremely high-cost methods used by most low/moderate-income households in emerging countries to get shelter. This examination suggests that modern management strategies well suit the challenge of squeezing the costs out of the low/moderate income housing process through creating “value chains” consisting of innovative packages of products and services. Involving citizen-sector organizations (variously called “NGOs”, “nonprofits”, and “the social sector”) in marketing and delivery can build the trust necessary for modern companies to reach low-income people with these housing packages, resulting in “hybrid” value chains (Ashoka, 2007).

A Hybrid Value Chain Framework for Meeting the Affordable Housing Challenge

Roughly 70% of the world’s population in developing countries (Ferguson, 2003) access shelter through “progressive housing.” In high-income countries, a sophisticated system of mortgage finance, title companies, real estate brokers, developers, and others allows the great bulk of households to purchase or rent a complete unit.

In contrast, most of the low/moderate-income majority of emerging nations cannot afford a mortgage loan to purchase the least expensive commercially-built home, formal rental markets are poorly developed, and – instead – households must build their housing themselves. This "self built", "incremental", or "progressive" housing accounts for the bulk of housing investment in most emerging countries.

For example, Table 1 analyzes investment in new housing in Brazil.

Table 1 - Methods of Production and Finance of New Brazilian Housing Per Annum

Production: Finance:	a. Progressive housing	b. Industrialized construction	Totals
1. Self financed by household	R. $48 billion (62%) 700,000 units (64%)	R. $22 billion (30%) 100,000 units (9%)	R. $70 billion (92%) 800,000 units (73%)
2. Private sector finance	R. $0.7 billion (0.9%) 20,000 units	R. $0.4 billion (0.5%) 50,000 units (5%)	R. $1.1 billion (1.4%) 70,000 units
3. Public sector finance	R. $3 Billion (4.1%) 130,000 units (12%)	R $2 billion (2.7%) 100,000 units (9%)	R. $5 billion (6.8%) 230,000 units (21%)
Totals	R. $52 billion (67%) 850,000 units (77%)	R. $24 billion (33%) 250,000 units (23%)	$R. 76 billion (100%) 1.1 million units (100%)

Source: Booz/Allen/Hamilton 2005 from Ferguson, Cherkezian, and Motta 2007.

In terms of volume, the mode of housing that is the norm in advanced industrialized countries – industrialized construction financed by credit – accounts for only $2.4 billion Brazilian Reais (Box 2a + Box 2b; one US dollar = 3 Brazilian Reais during this period) and 3.2% of total housing investment. In comparison, self-financed progressive housing accounts for R. $48 billion (Box 1a) and 62% of new Brazilian housing investment.

As many of the steps occur outside of formal institutions and legal markets, the bulk of progressive housing is "informal." In particular, the start of the progressive housing process through land invasions and informal subdivisions typically places the resulting neighborhoods outside of the formal land-use and building process.

Home developers seeking to go downmarket have also incorporated progressive-building techniques into their business. For example, most commercially-built moderate-income housing in Latin America consists of a core expandable unit without fixtures and finishing that families must expand and complete, typically in programmed steps.

Progressive housing represents the only affordable approach to shelter for most low-income households and many moderate-income families. This method often meets the immediate needs of these households far better than publicly-sponsored formally-developed housing. The advantages of progressive informal development typically include much quicker access, lower entry costs, more flexible monthly payments, location closer to jobs better suited to households' survival strategies, the ability to customize the construction of units to fit households' needs and resources, and proximity of friends and family. Not surprisingly, such progressive informal housing usually out-competes formal markets except when government bulldozes these settlements or actively eliminates them through other heavy-handed means. As emerging countries have democratized, the wholesale eradication of informal settlements, which contain much of the electorate, has become politically impossible.

Consequently, progressive housing development accounts for the bulk of new residential units in most emerging countries. The UN (UNCHS 2003) estimates that urban "slums" – which represent a part but not all of progressive housing development – contain 72% of the population of Sub-Saharan African cities, 59% of South-Central Asian cities, and 24% to 36% of the cities of other developing regions (other parts of Asia, North Africa, Latin America and the Caribbean, and Oceania).

However, the negatives of progressive housing are as striking as its positives. The process is typically highly inefficient and long, and exacts tremendous public and private costs over time. These eventual expenses overwhelm the upfront benefits when public and private institutions fail to serve these markets, as is typically the case.

Table 2 analyzes and describes progressive housing. The first column of this table lists the steps in the process and its overall characteristics in order to develop a framework for creating and assessing affordable home products and projects. Column 2 of this table provides illustrative quantitative estimates of the costs involved. Column 3 summarizes the goods and services necessary to streamline and squeeze the costs out of this process. In the context of the emerging literature on the topic of progressive housing (Ferguson, 2003; Ashoka, 2006; Greene, Margarita and Eduardo Rojas, 2008), this framework innovates in its cost estimates, level of detail, and usefulness as a tool to create and assess affordable home products of the private sector as well as public-sector programs and projects.

A review of the six steps in the process shows that progressive informal housing ends up costing many times more than formal-sector development. The first step of this process – acquisition of a lot of raw land – locks in many of these costs, creating a financial time bomb for government and households. Typically, households either invade public land or purchase a lot in an informal subdivision without full legal title. Land invasions predominated in the early stages of urbanization when many centrally-located parcels of vacant or underused publicly-owned land offered prime targets for occupation. In these beginning stages when land costs were lower, many cities also had legal low-income subdivision industries. Tighter urban land markets have now made illegal subdivisions on the distant periphery the main means of low/moderate income land development in most cities and, thus, the default mechanism for urban expansion (Ferguson, 2007).

These high costs come largely from fixing the problems created by informal settlement (steps 1a to 3a). Households pay clandestine developers many times (often, 10 to 20 times) their cost of purchasing this raw land for individual lots without receiving full legal title. They then struggle to keep physical possession and upgrade their rights to their lot (step 2) through keeping an adult family member (typically the wife) on site around-the-clock instead of working outside the home, bribing local police and officials, and paying the costs of regularization and registration of property ownership. In order to occupy the lot and begin consolidating their home and community, families build a makeshift shelter and acquire water and electricity via clandestine connections or by paying private suppliers many times the cost of publicly-supplied services for poor quality.

Upgrading this infrastructure (step 3) and building a permanent home (step 4) involves destroying these households' initial investment by retrofitting a new road/services layout to the community at two to three times the cost of formal-sector development and replacing the makeshift shelter. Households pay exorbitant rates both to save and to borrow to finance this process (step 5). During the consolidation phase (steps 3b to 6c), families and neighborhoods usually suffer from much higher rates of crime, violence, and insecurity of all types than formal settlements of a similar socioeconomic profile. Combating insecurity involves building community institutions (e.g. neighborhood associations and groups of all sorts), establishing alliances with supportive NGOs, and developing partnerships with public agencies (step six), particularly the police.

In addition to the steps of progressive housing, the process also has a number of key overall characteristics (detailed in the last three points of column 1 of Table 2) that impact government and society as well as the family: sustainability (scale, financial, political, and environmental), proximity to existing infrastructure and services, and targeting/affordability to low-income households.

Thus, the affordable housing/urban upgrading challenge involves many different interacting factors. Solving one of these difficulties in isolation has limited positive impact. For example, "sites and services" projects -- the most common low-income land program of many governments -- usually provide a building lot with "starter" infrastructure but include neither the building materials to construct a unit nor the inputs necessary to consolidate the infrastructure and the community over time. Predictably, sites and services projects usually suffer from partial occupation for long periods and end up benefiting many middle-income households that buy a lot for speculation rather than the poor.

Table 2

Steps, overall characteristics, costs, and goods and services for streamlining progressive housing

Steps	***Description and cost impact***	***Goods and services necessary to streamline process and reduce costs***
1. *Acquisition and occupancy of a lot* *a. Physically occupy lot* *b. Pay for lot* *c. Starter infrastructure (e.g. communal standpipes/wells or "tanker" water, dirt roads, electricity) for occupation* *d. Construct an initial makeshift shelter*	Occupation of public land. Professional organizers – sometimes in conjunction with public officials – assemble groups of households, conduct these land invasions, and charge households for these services. Often, these organizers or other local bosses continue to charge households for access to their land and services in informal settlements. Example: local mafias control energy distribution in the favelas of Rio de Janeiro, and add a surcharge of 10% to its cost. Purchase of a lot of raw land in an informal subdivision. Informal developers purchase rural land on the urban fringe, subdivide the parcel into as many lots as possible without adding infrastructure, and then sell the lots to households at many multiples the price of acquisition, partially capturing the value of subsequent infrastructure improvements and collective services provided by government. Example: In Bogota, "pirate developers" sell raw lots of 72 Mts2 to low-income households for US $ 2,000- that is, at almost US $28 per square meter (M2). In comparison, these pirate developers buy rural land in Bogota in the areas where illegal development predominates at less than 5% this amount - US $1.20 M2. (Maldonado, 2007). Households in informal settlements acquire some basic services via clandestine connections or by paying private suppliers. However, the quality of these services is low, the price is typically many times that of formally-provided service, and households often must bribe public officials to get or continue to allow these clandestine services. Example: Privately-supplied water is 5 to 10 times the cost of publicly-supplied water in Karachi's informal settlements and supplied by the infamous "tanker mafia" (Azfar and Rahman). Low quality and high cost also characterize the provision of electricity, sanitation and other services to informally settled areas in Jamaica compared with those of formal-sector development (Ferguson, 1996).	Formally-developed subdivisions with "starter" services (e.g. collective water and a gravel road network) located near trunk infrastructure lines.

Steps	*Description and cost impact*	*Goods and services necessary to streamline process and reduce costs*
***2.** Upgrading property tenure to achieve security of occupation* *a. Maintain physical control of the lot* *b. Achieve secure tenure* *c. Full legal title*	Initially, households typically lack secure tenure to their lot, and invest considerable amounts in time and money over long periods to maintain their tenuous rights and to hold it physically (Durand-Laserve, A and L. Royston, 2002; Habitat for Humanity International, 2008). Example: Studies have shown that women in Peru sacrifice their participation in labor markets outside the home in informal settlements largely in order to occupy the property physically in order to deter other claims to it, and that the main benefit of tenure regularization programs is to free up women's time (Morris). The cost of achieving full legal tenure varies widely among countries and within countries depending on the practices of local jurisdictions and the effectiveness of reforms, and is often less than the benefit to low/moderate income households. Examples: the full costs of registering title are US$400 to US$700 in Argentina (World Bank, 2006a), US $2,156 in Peru before title-system reform and US $200 after title-system reform (Morris, 2004), $2,500 in the Dominican Republic (Zanelli, 2008). Even after title reform in Peru greatly reduced the cost of full legal title to rates affordable to low-income families, however, households value formal title no more than many types of paralegal tenure that cost less and, as a result, fail to register new purchase agreements, allowing the property to revert to informality (Morris). Some cities and countries have created stable systems of secure intermediate tenure. Example: In Caracas, Venezuela, where around 60% of owner-occupants hold title to their property (located mainly on occupied public land) informally, a para-legal system of "supplemental title" (titulo supletorio) gives households effective security of tenure. Families can register this supplemental title to the improvements on the property – as opposed to the land, which, in theory, remains public – for free with the municipality once the application is prepared by a lawyer. Lawyers typically charge US $80 to $95 for this service, although public-service lawyers are available that will prepare this document for free for the poorest households that cannot afford even this sum. More commonly, security of tenure must be achieved on a case-by-case basis that varies with each informal settlement's legal and institutional history.	Legal, financial, and administrative assistance and upgrading security of tenure. Land developers, building materials retailers and manufacturers, and utility companies have an interest in increasing the security of tenure of the low-income communities that they serve.

Steps	Description and cost impact	Goods and services necessary to streamline process and reduce costs
3. *Provision of basic infrastructure* *a. Upgrading (e.g. road network, paving, drainage)* *b. Adequate sanitation (improved pit latrines or sewerage)*	Retrofitting irregularly-settled neighborhoods to provide basic infrastructure typically costs two to three times as much as provision to formal-sector and planned development. Examples: cost of provision of basic infrastructure to informal settlement in Sao Paulo was US $3,540 per unit, compared to that for formal-sector development of US $1,300 (Abiko et. al., 2007); cost of provision of basic infrastructure to informal settlement in Bogota was $3,362 per unit, compared to that for formal-sector development of $1,100 to $1,350 per unit (Metrovivienda, 2003); informal settlement also required US $572 per unit, on average, of extra costs for public works to mitigate risk of emergencies and disasters, titling, and relocation of a portion of residents. In Karachi, the capital cost of piped water supply, underground sanitation, electricity and roads was 1.8 times higher in a typical large informal settlement than a planned one (Azfar and Rahman, 2004). Typically, the last service to be provided is piped sewerage and treatment and many low and moderate income neighborhoods never receive sewerage because of its high cost. A much less expensive alternative is improved pit latrines.	Lobbying for and brokering infrastructure and collective services from various levels of government and private sector organizations. Organizing the community to help maintain and pay for installed infrastructure and collective services (e.g. cleaning drains, operating community centers)
4. *Construction of the house structure* *a. Improvement and expansion of unit of owner occupant* *b. Addition of accessory units and spaces for relatives and rental income*	The process of progressive house construction and improvement is long and wasteful. Example: In Mexico, the construction of a 9 square meter space (size of a typical bedroom) typically takes 4 years and costs 30% more because of waste in loss and poor use of construction materials, inadequacies of design, and mistakes (CEMEX). Household mix their own labor with that of specialized construction workers to the extent that they can afford it. For construction of a basic two bedroom house, the process typically takes 13 years if unassisted. · When unassisted, households frequently make technical mistakes in planning or construction that substantially raise final costs or result in lower quality. Example: focus groups of low-income progressive homebuilders in Brazil show that they often end up with asymmetric walls that lean to one side (Cities Alliance and Municipality of Sao Paulo, 2007) and other serious quality problems. These Brazilian households are willing to pay for technical assistance and want credit for specialized labor ..	Packages of high quality building materials. Technical assistance in design, budgeting, and construction of houses Market information on the type of home improvement and upgrading of property tenure that increases home values.

Steps	Description and cost impact	Goods and services necessary to streamline process and reduce costs
5. *Finance of steps in progressive housing process* *a. Household savings vehicles* *b. Small serial short-term credit for:* *-purchase of lot* *-infrastructure provision and connection* *-expansion and improvement of structure*	The finance of the steps in progressive housing – such as purchase of a lot, tenure upgrading, and construction of the house - occurs mostly through household savings (Mitlin 2008) supplemented by small credits. However, low-income households typically pay very high rates both to save and to borrow. Example: the most widespread form of savings – informal savings clubs – carry substantial costs; that is, households get back significantly less than they put in; Rutherford's seminal study on the savings of the poor calculates that households typically pay 30% per annum to the organizers of informal savings and credit clubs (called "Accumulating Savings and Credit Associations" -- ASCAs -- in the microfinance literature) in order to save. When households open accounts at formal-sector financial institutions, the interest rate paid is often negative in real terms (taking into account inflation); In addition, the institution charges fees for services, and the saver must pay for transport and spend time to make deposits and withdrawals. The most widely available source of small credits for low-income households consists of informal moneylenders, which typically charge very high rates of interest – 180% per annum is not uncommon (Rutherford, p. 19). Alternatively, informal savings and credit clubs charge, in effect, somewhat less for credit to participating members; 80% per annum is an illustrative rate (Ibid, p. 24). The most efficient form of savings and credit for the poor – Rotating Savings and Credit Associations (ROSCAs) - where all households contribute a set amount each month and one household "wins" the pot every month based on a lottery – carry effective lending rates that are much lower, but still substantial; Rutherford's example of a typical ROSCA results in credit at 26% per annum (Ibid, p. 28).	Organizing groups of households to save for home upgrading and to demonstrate creditworthiness Saving vehicles that create discipline and give a positive real interest rate A range of credit including: microfinance; supplier and consumer credit from developers and building materials retailers; and small mortgage loans; not only for building materials but also for specialized technical labor.

Steps	***Description and cost impact***	***Goods and services necessary to streamline process and reduce costs***
***6.** Building community institutions to combat insecurity* *a. Formation of neighborhood groups* *b. Local and international NGOs support neighborhood groups* *c. Neighborhood groups and NGOs partner with public and private sector to increase security*	Crime, violence, and "insecurity." Irregularly-settled neighborhoods have substantially higher levels of insecurity, and poorer health than other neighborhoods of households of a similar socio-economic profile. Strengthening and working with women's role and citizen sector organizations is key to building trust, reducing insecurity, and selling appropriate packages of products in these neighborhoods. Examples: 70% of surveyed residents of one consolidated irregularly settled informal low-income community in Karachi had been victims of violence or robbery in this area, compared to only 2% in a planned low-income community with comparable demographics (Azfar and Rahman, 2004). In Jamaica, residents of many irregularly-settled communities are unable to get jobs as a result of the bad reputation of their neighborhoods (Ferguson, 1996).	Organizing community associations and funding sources to operate them. Developing women's networks to market goods and services Community centers with daycare and youth facilities Agreements with the police and other authorities that enhance security Investment in street lighting and local police stations

Steps	***Description and cost impact***	***Goods and services necessary to streamline process and reduce costs***
Overall characteristics	***Key questions -- extent to which***:	
1. Sustainability *a. Scale* *b. Financial* *c. Political* *d. Environmental*	 a.. …project/product meets demand/need? b. …revenues cover expenses? c. …project/product is independent of uncertain actions or subsidies of government? d. …project/product improves or avoids damaging the environment?	
2. Location relative to existing infrastructure, services, and jobs	a. …project is distant from existing infrastructure lines, services, and jobs? b. …this distance increases costs? c. …these costs are borne by government?	
3. Targeting/ affordability	a. …product/project is affordable/targeted to low-income households?	

When government programs succeed in integrating a sufficient number of steps to be truly useful to households, they tend to involve large subsidies per family and become boutique showcases – successful for a well-connected or lucky few but financially unsustainable if expanded to a substantial share of the population. Because of these high subsidy amounts, government affordable housing projects are seldom market-based and have limited scope.

No wonder that informal progressive housing development has been called a "devil's bargain" and labeled as the principal agent in creating a "planet of slums" (Davis).

In this context, modern management methods – particularly a "hybrid value chain" approach (Ashoka, 2006) – well suit organizing, streamlining, and squeezing the costs out of the progressive housing process. Broadly, a "value chain" consists of the delivery of a mix of products and services to the end customer by different economic actors resulting in new business models that cut costs and/or enhance worth. The industry-wide synchronized interactions of those local value chains create a "value system" (Michael Porter, 1985).

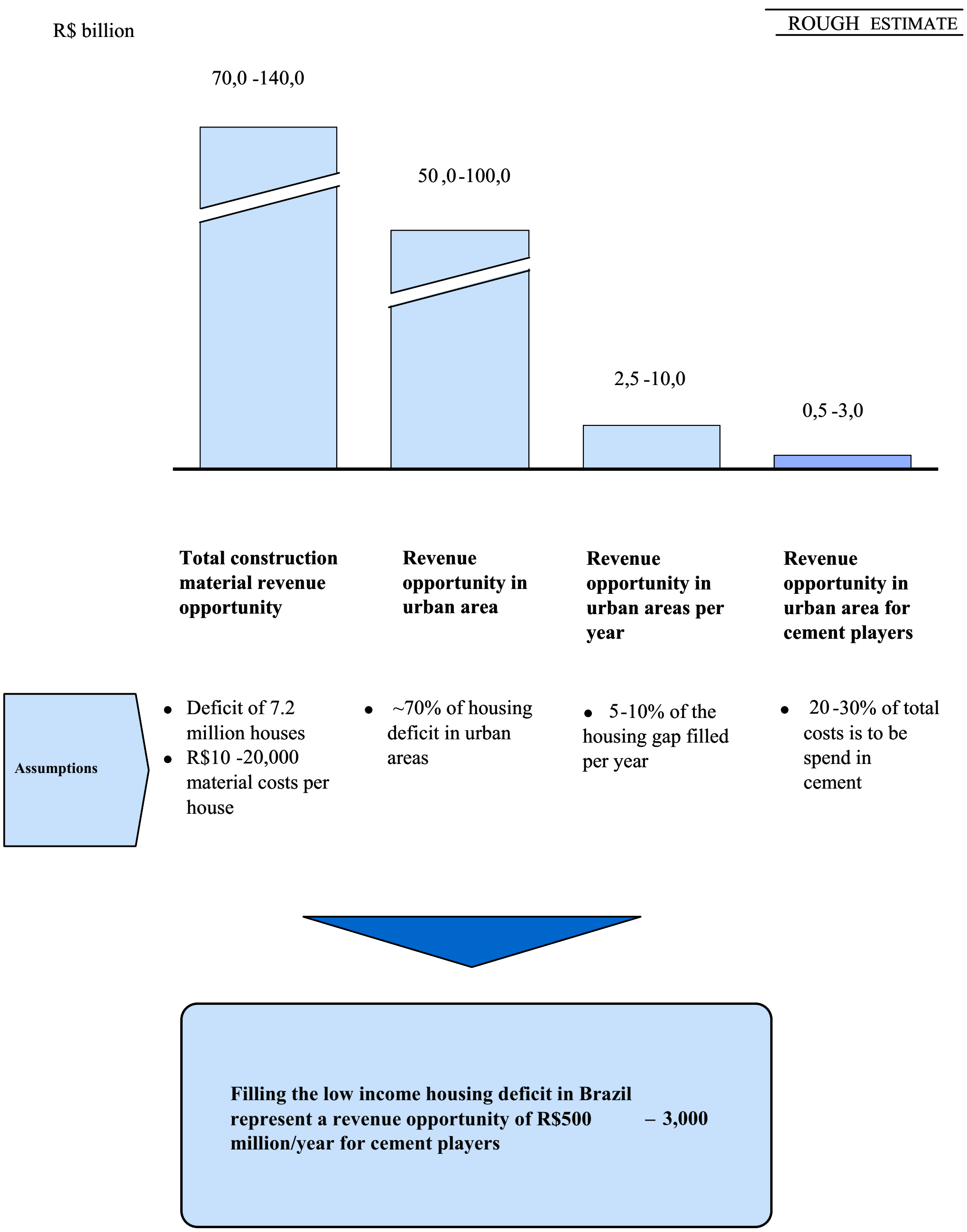
The high costs that represent problems from the perspective of households and government constitute enormous potential markets for housing goods and services from the point of view of companies. For example, Figure 1 broadly quantifies the opportunity for construction materials sales, in general, and cement producers, in particular, in low-income housing in Brazil (Ashoka, 2007).

Such supplier estimates are a highly useful complement to the perspective of households (that of "demand" – column 2 of Table 2). In particular, they demonstrate that ample markets do, indeed, exist at the bottom of the pyramid in housing and turn affordable housing and community upgrading from "problems" and "deficits" to be addressed mainly by government subsidies of limited scope into business opportunities for products and services capable of expanding to massive scale.

However, taking only a supplier view – particularly one focused on one product or service of a particular company – over-simplifies the problem and the task of designing products for this segment, and under-estimates the market that can be created by solving sections of it. In order to design products and assess markets accurately, companies must also examine low-income housing from the perspective of households and view their main product or service within the family's overall housing problem. Good examples of such investigations include the market studies of CEMEX in Mexico (Michigan Business School, 2003) and Corona in Colombia (Trujillo-Cardenas and Gutierrez, 2006) that have informed the design of their bottom-of-the-pyramid products.

The key to creating value and, thus, markets in affordable housing is not only to lower the costs of each of its steps but also, more importantly, to innovate and join products and services together into new business models that address larger segments of the problem. To this end, column 3 of Table 2 lists products and services that can help reduce costs, particularly when assembled. For example, a company that not only offers high-quality, low-cost building materials but also provides competitive credit to purchase these building materials will create much greater effective demand than separate provision of these products without coordination.

Figure 1 -- Estimate of the Construction Material Market Opportunity in Low Income Housing in Brazil



Source: Ministério das Cidades, IBGE, MCT, Ashoka, Team analysis

Broadening this package to include remittance services (for sending money from family members in other countries to help their relatives invest in housing), savings vehicles with positive real rates of interest that organize and encourage families to set aside money regularly for home construction, and technical guidance for the design and construction process will expand the total market still further. Such packages will displace high-cost suppliers of these inputs -- i.e., the savage informal markets that make progressive housing many times more expensive than formal development.

For example, CEMEX has found that selling only cement fails to reach effectively the self-help housing market in Mexico, which constitutes 40% of sales and withstands downturns much better than the formal-sector cement market. Instead, this company discovered that it must provide a complete housing solution at low cost through joining microcredit, a savings program, technical assistance in design and building, and other building-materials with cement in its well-known bottom-of-the-pyramid program, *Patrimonio Hoy*. In effect, Cemex has created a product/service package for low-income households to build their home in two to three years rather than 16 years (the median for self-help housing in Mexico). The company projects serving one million Mexicans under this program by 2010 and has recently added remittance services and product/service packages to build neighborhood streets and schools to this core self-help housing product.

The synergy created by product/service packages holds much greater importance than competing on price alone on one product. In effect, households value this synergy over deep discounts. For example, Cemex and Corona offer their central product (cement and floor tiling, respectively) at competitive rates but not the lowest cost and avoid price wars.

Although modern companies well suit the provision of packages of high-quality inputs to squeeze costs out of the progressive housing process, they typically have little direct access to poor communities, which they find dangerous and difficult places in which to work, and to low-income people, who usually do not trust them. As a result, citizen-sector organizations can perform an important function at critical junctures in the value chain. In the words of Corona, a Colombian building materials manufacturer and retailer with a bottom-of-the-pyramid product for poor communities, “we cannot work in these places directly and channel our products through NGOs. ”

The roles suited to citizen-sector organizations include empowering households and the community as well as marketing and delivery of the product/service package. CEMEX and Corona employ neighborhood women as sales representatives for these functions. CEMEX’s networks of female sales reps has proved crucial in overcoming the resignation of low-income households to the length and the high cost of typical self-help housing and in motivating families to participate in a program to build their homes in 24 to 36 months rather than 16 years. While mass media (radio, television) fail to reach these neighborhoods, the local women sales reps of Corona and CEMEX have generated a steady expanding volume of business for their bottom-of-the-pyramid products.

Consequently, a “hybrid” value system that joins the strengths of for-profit modern companies with those of citizen-sector organizations can best deliver affordable housing products (Ashoka, 2006). For similar reasons, citizen-sector organizations also can provide the critical intelligence and relationships to use public subsidies well in these neighborhoods. Although citizen-sector organizations can play a role throughout the progressive housing process, they can contribute most to “building community institutions and combating insecurity” -- step 6 of Table 2. For-profit firms typically focus on selling product/service packages to build houses and then exit. In comparison, citizen-sector organizations stay involved in consolidating the community, which -- in effect -- expands markets long-term. The long-term stewardship of citizen-sector organizations can create enormous public and private benefits. Increasingly, modern companies recognize the strength by involving and supporting nonprofits in their bottom- of-the-pyramid programs. The size and collective nature of these benefits also justifies public support of effective NGOs.

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WWB GENDER STUDY: THE CAPACITY OF POOR WOMEN TO GROW THEIR BUSINESSES IN THE DOMINICAN REPUBLIC

Inez Murray

Introduction

Providing credit to poor women is a great way to enable the financial stability and economic progress of low-income households. But because of gender-based constraints, burdens and responsibilities, in the Dominican Republic as in many countries, more than credit is required if women are to make real progress in lifting their families out of poverty.

Gender-Based Business Constraints

The poor women of Santo Domingo who are the focus of this study are responsible for meeting all of their families' needs except basic housing and food. The expenses associated with the education of children, health care, clothing, furniture, and family emergencies all fall on women's shoulders. This limits their capacity to reinvest profits into their businesses.

Time-allocation for women is also a major constraint. Women who go into business to provide for their families' needs must incorporate the demands of their business within an already full schedule of child care, cooking, cleaning and caring for relatives. Despite these burdens, women's traditional status within the family and in society is low. Women may bear the burdens, but men call the shots. Yet as this study shows, these dynamics change and women's autonomy grows as they earn income.

Women's gender-based, personal priorities also play a role, influencing their motives for going into business, their choice of business options, and the goals they hope to achieve through their business ventures. Women tend to equate success with stability and a secure future, rather than with an accumulation of capital or business assets. Securing a better life for their children through education and a steady income for their own old age tend to be women's first priorities. Moreover, when women receive support to engage in business, their increased autonomy within the household, their growing independence and self-confidence are, for them, tangible rewards of work.

Women of Santo Domingo Speak Out

Between 2002 and 2003, Women's World Banking conducted in-depth interviews and focus group discussions with 130 women and men, clients of the microfinance institution ADOPEM from low-income neighborhoods in Santo Domingo. Assured of anonymity, interviewees spoke candidly about gender-based family dynamics, the demands of home and work, the financial pressures they face and the survival strategies they employ. The objective of the research was to paint an authentic picture of these women's lives, enabling ADOPEM to better understand their needs and to design and offer a wider variety of responsive products and services to ensure that poor women meet their primary goal of financial security for their families.

Ana Celeste Genao Rodriguez: A Widow Finds Security with Family Support

Ana Celeste Genao was 23 when her husband died 18 years ago. She had three small children, the youngest just four months old, and no means of support. She moved back with the children to her parents' small wooden house, where her brother and sister were also living. Her family helped her go to university for two years to study accounting. After university she worked as an accountant in a liquor export business. Her uncle ran a small grocery store on the plot of land where the family was living, but it was not doing well.

Becoming a store-owner

In 1988, Ana Celeste's aunt, who was living in New York, encouraged her to take over her uncle's store and lent her RD$3,000, or US$136[1], interest-free. This she used to pay her uncle for the existing inventory. There was a refrigerator and freezer in the store that belonged to her mother, so she continued to use them. She gradually built up the business. She took out her first loan from ADEMI, a microfinance institution, for RD$20,000 and used it to finance the construction of a two-story cement house on her mother's property. She managed to repay the loan with the profits from her store. That same year she took out another loan from ADEMI (RD$30,000) and bought an electricity generator, as well as an awning for her store.

In 1999, Ana Celeste took out her first loan from ADOPEM (RD$10,000) to build shelves in the store and buy inventory. Her business improved as she gradually upgraded its inventory and equipment, some of which she acquired on credit. For example, her fruit juice display cabinet cost RD$26,000; she paid the supplier RD$3,000 up front and then paid off the rest in equal monthly installments, with no interest. Similarly, she paid RD$3,000 up front for her beer freezer, in equal monthly installments with no interest.

Building an apartment

Ana Celeste has combined credit from ADEMI and ADOPEM, as well as profits from her business, to finance the construction of her apartment in the new cement house. She borrowed an additional RD$50,000 from ADEMI to help pay for the construction. Her second loan from ADOPEM, taken in 2000, paid for the windows.

Ana Celeste's third loan from ADOPEM, in November 2001, was for RD$25,000. She used RD$20,000 of it to stock up on beer (one of the highest margin items in her store) and put RD$5,000 toward buying a computer for her daughter. She also took out a loan (RD$15,000) from an organization called PROMIPYME to buy the computer. Her most recent loan from ADEMI was for RD$100,000, which she used to buy furniture for her house.

Ana Celeste's only income source is her store. Thanks to her family support network and to the availability of credit, she has built up a business whose daily cash income enabled her to raise her three children and build her apartment. Although the property legally belongs to her mother, she pays her mother rent only for the ground floor where the store is located. Ana Celeste expects to eventually inherit the property from her mother.

She opens the store early in the morning and closes it around 11 p.m. She usually has the help of one of her daughters between 2 and 5 in the afternoon. Most afternoons she can rest, but on Mondays and Thursdays she shops for vegetables and grains in the market. Her younger daughter helps her in the evenings.

Differences in Perceptions of Women's and Men's Roles and Responsibilities

The men and women interviewed differed in their perceptions of how well each of them fulfilled their respective roles and responsibilities. The women felt that their economic contribution to the family income and their housework-related accomplishments were undervalued and little recognized.

At least some of these differences of opinion originate in the "machismo" aspect of male identity. Infidelity creates mistrust, lack of transparency and lack of communication. It also increases the possibility of abandonment. The diversion of part of the man's income to what is perceived by women as unnecessary expenses (alcohol, gambling, recreation, friends, lovers) has a debilitating effect on the household economy. Having multiple families – particularly in this low-income segment of society – limits the amount of money men can spend on each one, which may account for why men limit their financial responsibility to just food and housing. Finally, conflicts over "machismo" affect the development potential of both men's and women's businesses, because distrust, unease and disagreements limit possibilities for cooperation or development of joint projects, whether economic or social. Women interviewees confirmed that cooperation inside the household was important to their success in business.

Men and women differ about what it means to take responsibility for the household. While men perceive themselves as heads of the household with ultimate responsibility for the family, women say that in reality it is they who are responsible for everything in the home.

- This difference in perception versus reality gets played out most notably in the financial arena, where men limit their responsibility to paying for food and housing while women have to pay for everything else: additional food, clothing, school fees, medicine, furniture, etc. Women perceive this to be totally unfair.

- Another area of difference between perceptions and reality concerns what it means to be a father. Women argue that men see this role as simply "fathering" children and having basic responsibility for them, rather than taking on the responsibility for "parenting." Hence, a phenomenon that could be described as "absent fatherhood" is relatively common – whereby men live in the same house as their children but do not act as parents.

- Women's shift into income-generating activities has not been met with a comparable shift in men taking responsibility for the housework or managing the household. This means that the majority of women interviewed work very long hours and juggle a huge number of tasks. While women acknowledge that this is hard, it was not a significant source of discontent.

Aspirations and Definitions of Success

When asked what they aspired to in life, most interviewees mentioned goals such as living in a home they could call their own, having their children become professionals, upgrading their own education and ensuring that they had financial security in their old age.

Measuring the "success" of microentrepreneurs by the growth in sales of a single business ignores the multiple sound investment allocations households make in order to cater to present and future needs. Broadening the definition of success to include housing, the education of children and oneself, and financial security for the present and the future is more useful in explaining strategies that households engage in.

Horizontal and Vertical Strategies: Growing One Business vs. Diversification

The likelihood of growth for a single business is compromised because most households prefer to have several businesses. Women especially were likely to have a number of businesses (horizontal investing), whereas men are more likely to plow their earnings back into a single business. Women's horizontal investment strategy lowers the vulnerability of the household in case of business failure (not putting all their eggs in one basket), and smooths the income flow over weeks, months and years. But it also limits the growth potential of the woman's primary business.

Florentina Diversifies: Lunch Business, General Store, SANES, Rental Properties

Florentina Reyes has a successful lunch business, but a year after she started selling lunches, she began to diversify her business activities. In 1988, she borrowed RD$125 from a friend of her husband and started a small "store" – a table in her wooden house – where she sold coffee, sugar, bread, cookies, mints and cigarettes. Her son's godmother, who lives in New York, gave her some cloth to sell in order to pay back the RD$125 loan. She bought a freezer for RD$20,000 with store credit and started making fruit juices and ice cream to sell. She saved between RD$20 to RD$30 a day from the ice cream and fruit juice sales to pay the monthly installments for the freezer. She soon added soft drinks and beer, which have a higher profit margin.

Investing in rental properties

In 1990, Florentina organized a SAN for 40 pesos a day which provided her with a lump sum to invest. She combined that with some of her earnings from the lunch business and her husband's wages, and gradually bought cement blocks. Over the course of a year, Florentina's husband constructed concrete walls around their wooden house. They shifted the wooden house to the side of the concrete structure and finished off the concrete structure with a roof. The family then moved into the concrete house and rented out the wooden house for RD$500 a month. This was her first rental income. The household at this point had four sources of income: the lunch business, the store, rent and her daughter's earnings.

In 1997, Florentina won RD$1,000 in a lottery. Instead of spending it, she combined it with her first loan from ADOPEM (RD$4,000) and bought the construction materials with which her husband built two rooms above the main house. They rented these rooms out for RD$800 a month each. Every month she used the rental income to pay off the loan from ADOPEM and to buy more construction materials. Meanwhile, the profits from her two other businesses were used to restock those businesses and cover household expenses. The family's main meal came out of the same food that she cooked each day for her lunch business, and the merchandise she bought for her store was also used at home.

In 1998 Florentina took out her second loan from ADOPEM (RD$8,000) to buy more construction materials, with which her husband built two more rooms. Each room was rented out for RD$800. At this point, the family's total rental income per month was RD$3,700, or US$168. It is important to note that at this stage the bulk of the household's expenses were paid out of the lunch business and the store rather than out of the rental income. The latter was earmarked to pay off the loan from ADOPEM and the store credit she received from the hardware store for the construction materials. With whatever was left over, Florentina continued to invest in construction materials to build additional rooms. Her husband was now 67 years old and his capacity to earn money had diminished. He continued to get some paid work but focused mostly on building rental units in the family compound.

In 1999, Florentina received her third loan from ADOPEM (RD$15,000) and borrowed another RD$25,000 in 2000. This fourth loan was used to build a bathroom inside the main house and to buy a radio for the family. In 2001, Florentina borrowed for a fifth time from ADOPEM (RD$40,000) and built a little two-room house behind the family house. They rented each room for RD$900. At this point her wooden house was earning RD$900, so that her total monthly rental income was RD$5,900, or US$268. As always, she used the rent to pay off the loan from ADOPEM and her debts at the hardware store. She also used part of it to pay back the grocery store that supplied the inventory for her lunch business and store.

In 2001 she decided to close off a portion of her front porch and relocate her store there. This was a good location on a busy street. At this time she also started selling clothes to the employees of the company where she sold lunches. She thought this would be a good business too, but unfortunately it did not do well and she stopped it in 2002.

In 2002, Florentina borrowed RD$60,000 from ADOPEM and RD$20,000 from an associate who is a lawyer with the aim of building two rooms: one for rent as a store front and the other above the store front for rent as accommodation.

She still owed ADOPEM RD$13,000 from the previous loan and ADOPEM deducted this amount from the RD$60,000. At the time of the WWB interview (March 2003), the store front had been completed and was rented for RD$3,000 per month. Florentina's husband was finishing the floor of the room above it. The expected income from that room is RD$1,500.

Florentina was able to pay the lawyer most of the RD$20,000 very quickly since she managed to rent the store front and secure RD$21,000 up front from the tenant. This included RD$9,000 for three months rent; RD$9,000 as a deposit and a real estate commission of RD$3,000. Florentina still owes the lawyer RD$2,000 and said that she will pay him with the June rent. She has hired this same lawyer to collect the rent from all her tenants for which she pays him a 10 percent commission. Her monthly rental income in July 2003 will be just under RD$10,000, or US$454.

In Florentina's words, her "main business is building rooms to rent" and her investments have paid off handsomely because of the following reasons:

- Horizontal investment – diversifying in more than one business – makes a lot of sense for many households, since with more than one business, money comes in at different times. It also lowers the vulnerability in case one business fails.

- Diversification also helps women manage time, as some businesses, such as hairdressing, require active management, while others, such as renting a room, require only passive management.

The Capacity to Invest Money in the Business

The capacity of women to grow their businesses through reinvestment of profits is often limited by the various demands placed on their earnings. Since women feel responsible for meeting all the needs of the family (except for housing and basic food) they see their business more as a means of sustaining their household, rather than as a vehicle for growth.

Financial needs beyond business investment

Both female and male interviewees were asked to identify and discuss the lifecycle events that exert the most financial pressure in their households. The interviewees were asked to indicate the amount of financial pressure by allocating the numbers 1 (low pressure) to 5 (high pressure) to each lifecycle event. The participants were then asked to discuss how they cope with these lifecycle events at present and what kind of products a microfinance organization could provide to help them respond to these events.

The events that place the most financial pressure on households are housing, children's education, health, the costs of dying (both funeral expenses and ensuring that their dependents are taken care of), and the costs of old age. It is interesting that in terms of financial pressure, education received more points than ensuring enough resources for old age. Perhaps this can be explained by the age of the interviewees (most were under 40), which would make the education of their children a need more immediately felt. It is also possible that some interviewees are assuming that their children, if they receive a good education, will support them when they are old.

While households engage in a series of strategies to cope with these events, i.e., borrowing from institutions and each other, saving and liquidating assets, there is no doubt that there is enormous demand for affordable and flexible savings, insurance and loan products tailored to each lifecycle event.

1. Housing

- Housing is the most important investment for the present and the future.[2]
- Housing is also perceived as a source of income for the present – and as security and retirement income for the future.
- For women, investing in housing reduces financial vulnerability in the event of abandonment by their husbands.[3]
- Like low-income people everywhere, interviewees build their houses gradually.

2. Education

- Education represents the second highest economic pressure after housing.
- Education (public as well as private) is very expensive and many parents find it difficult to afford it.
- The public school system is perceived to be of very poor quality. Most parents try to send their children to private school if they can afford it.
- Access to savings products would help families pay for schooling.

3. Health Care

- The ability to cover expenses for sickness is literally perceived to be a life or death issue.
- There appears to be consensus over the fact that the health care system is inadequate.
- Strategies for covering health expenses include savings, borrowing money from family members and neighbors, selling household items and reaching out to NGOs.
- Some interviewees paid for private health insurance (i.e., people with greater economic capacity) or received it as a benefit from working in the formal sector.
- There is some mistrust of existing insurance vehicles, and some interviewees said that you are better off paying with cash. But most people agreed it was crucial to have some kind of health insurance.
- Affordable health insurance would reduce the vulnerability of poor households considerably.

4. Old Age

- Women with low business sales were the only group to identify old age as one of the lifecycle events that exerted the most pressure.

- Strategies for covering financial needs during old age include saving and investing in property and children. Pension plans exist only for those who have formal employment.
- A long term savings account with insurance that guarantees the payout if the saver dies before term is a product increasingly seen in the microfinance sector. More work needs to be done in designing an affordable pension product for the informal sector.

Gender Roles and Household Expenditure Patterns

In general, men and women agreed that men's minimum responsibilities include covering the family's basic necessities: buying food and paying for housing. The women perceived themselves as being responsible for all other expenses, including clothing for their children, education-related expenses, furniture and other household items, and health-related expenses.

These differences in perception may be partially explained by men's and women's actual roles. The men do not participate in managing the household and they do not do housework; thus, they are unaware of what the financial requirements are. Moreover, women attach value to replacing or buying furniture and other household items that men see as superfluous.

There are also differences in perception regarding the use of discretionary funds. Most of the women think men squander money on alcohol and other women, while the men think women like to go shopping and that they spend more than is necessary on clothing, perfume and getting their hair done. Yet when forced to decide whether to spend money on something for the family or on something they want personally, it is the women who choose to spend on the family.

Diverting business profits for household expenditures

Most women interviewees reported that they had to divert a portion of their business profits to household expenditures since they were responsible for all household expenditures with the exception of housing and food. This diversion of profits gets more extreme the poorer the household. Business earnings are distributed among such areas as savings, education of children and concrete blocks for construction or additions to their houses. This type of behavior, though rational, limits the amount of profits that women reinvest in their main business.

- Men and women appear to have different perceptions of the resources needed to manage a household. Women think that men underestimate expenditures, and men think that women overestimate them. Women think that this is because men are simply unaware of the costs in time and money needed to manage a household because they do not engage in these activities. These different perceptions easily lead to frustration and conflict.

- The male tendency to give minimum financial support to his family may be traced to his gender identity. Since part of his identity involves having more than one family, it follows that he cannot afford to support each family in a more substantive way.

- Another expression of masculine gender identity – the image projected to the outside world and the right to have a good time – is seen in the importance men attach to buying a car. While many men rationalize the expense as being necessary for their businesses, many women see the car as a way of showing off success to other people and, therefore, as an expense that is often unnecessary. Whether or not the car is used for the business – men are not shy about justifying the purchase of a car for the sake of their culturally-perceived masculinity.

- Understandably, the most volatile of these issues is the use of a man's earnings (and in some cases, the woman's) on "other" women. Men seem to justify this expense in terms of their masculinity, as they justify the purchase of a car.

- Some men reported that some women spend more than necessary on the children and on themselves.

- Conversely, many women feel that men not only squander their discretionary income on their own entertainment and consumption, but that they spend important household finances on these things.

- Men acknowledge that they manage, and decide how to use, at least some of their income, and that this income is often used for their own entertainment and consumption.

- If they have to decide between allocating funds for their own consumption or for a family need, women tend to give priority to family needs over their own interests. Women appear to have significantly less right to have discretionary income than men.

- Although women react to the unfairness of these situations with varying degrees of hostility, most women make the necessary compromises.

Gender Roles and Saving Patterns[4]

Because men and women exhibit different behaviors and priorities with regard to spending, women have adopted covert patterns of saving that permit them to cover immediate household costs and prepare for unexpected future expenses. To protect their savings and reduce the risk of loss, women often choose to hide their savings from their husbands.

Women save wherever they can, in piggy banks at home, and most are involved in ROSCAs (Sanes) as organizers and participants. Saving by purchasing cement blocks is also popular.

Interestingly, lending money was mentioned by many participants as a savings mechanism, because it earns a much greater return than many investment activities: 40 percent a month, far more than any savings vehicle could offer.

Women tend to save from their housekeeping money as well as from their businesses, on a daily basis in small amounts. By contrast, men who save usually do so in bank accounts and for a specific purpose. In part, savings-related behavior can be explained by gender identities and gender-prescribed roles and responsibilities. Women, who manage daily spending, understand that money is spent or saved peso by peso. Men, on the other hand, may think that saving in tiny quantities is not worth the trouble, or may implicitly assume that their wife will take care of it.

- Most women interviewees were critical of men's attitudes regarding savings, saying that men tend to focus on the present and squander money instead of saving for the future. Women consistently said that men do not save and, for that reason, women are the ones who must save.

- Many men acknowledged that women are thriftier than they are and, to a certain extent, they feel that saving is the women's responsibility.

- The reasons people save differ by household income. The poorer households tend to save only for emergencies, while the better off also save for school fees, to buy plots of land, to pay loan installments and to supplement their loans to make other investments.

- Most men and women are saving for medical expenses, to purchase a home or make home improvements, and for educational expenses.

- Women adopt various saving strategies: They stretch their housekeeping money as much as they can, or they tend to tell their male partners that they need more money for food and other household expenses than they actually do, which allows them to save what is left over.

- Women keep savings separate from men in many households simply because, if they do not, men will either want to use the money or will contribute less housekeeping money. They also do not tell their male partners how much money they earn.

- It is notable that gender does not deter men from saving (overtly, in bank accounts) for specific purposes, such as another business, a house, or a car. Nor does gender prevent women from using their savings to actively invest. Both men and women frequently buy cement blocks and reinforcing bars to build houses. Women – the better savers – do it more.

Informal Savings Mechanisms

One traditional savings mechanism which exists in many countries is the Rotating Savings and Credit Association (ROSCA). Known as SANES in the Dominican Republic, they consist of groups of individuals who make regular cyclical contributions to a common fund. For example, 20 people each contribute 100 pesos a week for 20 weeks. Each week one person can access the entire amount, i.e. 2,000 pesos, until the 20 weeks are up. Each person's turn is usually determined by lottery, but if a member of a SAN is in great need, the group will give priority to them. In Dominican society, all income groups participate in SANES.

SANES are used for multiple purposes, including generating a lump sum that can be used to invest in a business or a plot of land or to pay off a loan or school fees. A SAN has several advantages over the piggy bank that make it attractive to poor women: It is very convenient in that money is collected and taken away from the house, making it harder to dip into and it enables women to save small amounts on a daily basis. A SAN can be kept confidential from one's husband and it facilitates saving for a particular goal. The element of chance, such as gambling on the fact that one will get the payout quickly, also appeals to the Dominican psyche. Although some men reported using SANES, they are used most extensively by women.

Bethania Organizes SANES

In 1997, Bethania Rodriguez started organizing SANES with her neighbors. One of Bethania's most recent SANES will serve as an example:

On February 26th, 2003, Bethania finished a SAN that had five participants, each of whom contributed RD$100 (US$4.50) a day for 60 days, a total of RD$6,000 each or RD$30,000 for the entire SAN. The payout was every ten days and the payout sequence was determined by lot. Interestingly, the payout amount was just RD$5,000 because Bethania as the SAN organizer was entitled to a payout without contributing any money to the SAN. This was her fee for organizing and managing it. In addition, as the organizer Bethania got the first payout. She received this lump sum just ten days after she had organized the SAN.[5]

Bethania usually runs a couple of SANES at a time and has done so more or less continuously since 1997. She usually goes to collect the payments from the participants but sometimes they bring the money to her. She uses the profits as investment capital for her various other business ventures, as well as to pay off loans from ADOPEM.

- SANES are an immediate and convenient way to save small amounts of money for a variety of purposes: school tuition, purchasing household items, inputs for a business, paying back a loan or home improvements.

- Women also use SANES to generate income and to finance their own customers.

- When designing savings products for this population, it is crucial to build on the features of informal savings mechanisms.

Gender Roles and Investment Patterns

Gender roles, as well as lack of access to health insurance, life insurance and pension plans, determine men's and women's investment patterns. Although both male and female interviewees said they give priority to investing in housing and in educating their children, the women – in view of their responsibility for raising children – tended to put more emphasis on these investments than did the men. In some cases, the men said that they would resist investing in housing if there is any doubt regarding the permanence of the relationship, because if the couple separates, the woman will probably end up keeping the house. Since 2003, WWB has worked with ADOPEM to introduce savings.

- Property, particularly housing, is seen as the main investment vehicle, and women seem to put more emphasis on buying a house.

- The income from renting out houses and rooms is a way to cover current expenses, such as children's education, and ensure income for the future, especially during old age.

- Both men and women interviewees said that a house was an investment that could be left to their children.

- Nearly everyone mentioned investing in education, so that their children would have professional careers and a better life, but also so that their children would help them in their old age.

- Helping this population to build assets by offering well-designed credit and savings products – and protecting those assets by offering insurance – helps the microfinance provider achieve the "double bottom line."

The Capacity to Invest Time in a Business

Women's roles in household maintenance, child rearing and as the primary care giver to the extended family (parents, siblings, etc.) place significant limits on the amount of time they can devote to their businesses, thus limiting their businesses' growth potential. Ideally, women would like part-time or flexible working hours.

The importance of a support network

Women who have succeeded in growing their businesses often receive support from female family members (mothers, sisters, daughters, etc.) for childcare and household tasks. Conversely, lack of this type of support limits women's business success.

The provision of affordable childcare would have a major impact on women's business growth. This issue is a familiar one wherever and whenever women have the opportunity to vent their feelings about matters that deeply affect them. For Dominican men, on the other hand, it is a non-issue. Wives, sisters, mothers will always step in to look after their offspring.

Supporting an extended family as a means of ensuring old age security is especially evident in women's priorities Having little discretionary income and the burden of their children to support, there is limited scope to save for retirement or unemployment. Women, therefore, must depend on maintaining their networks and links to family and friends.

Conclusions and Recommendations

By looking at the gender dynamics of the household, this research sheds light on the complex lives of a small group of ADOPEM clients. It also documents some of the diverse strategies these clients employ for managing household economic portfolios. The findings not only reinforce WWB's understanding of low-income people's need for a diverse range of financial products, including credit, savings, and insurance; they also have implications for potential non-financial inputs such as child care and health care services, training on gender relations and women's rights, and finally, business development services.

Within Households, Diverging Priorities

- Individual members of a household have separate – if not competing – preferences, constraints and resources and make individual as well as joint decisions.

- Individual members of a household cooperate in certain decisions and not in others. As a result, both cooperation and conflict may coexist in the household.

- The strategies of individual members reflect differences in their bargaining power, which in turn reflect differences in their access to resources and in their roles and responsibilities.

It is important to acknowledge these differences and analyze the gender-related factors that have an impact on the management of a family group's "economic portfolio." Management strategies differ depending on household income level: the poorest family groups tend to be the most vulnerable to risk, and different families manage risk in different ways. Financial services can play an important role in changing the way risk affects the economic decisions of the family group and its members.

Although men play a recognizable role as heads of household and are responsible for food and housing, most households need more than one income to survive. Thus, increased participation by women in income-generating activities has influenced intra-household dynamics. Although men place an increasing value on women as generators of income, they still do not value unpaid household work done by women. But if women did not do this type of work, someone would have to be paid to do it.
Economic activity generates income that in turn generates power; thus, as women earn money they begin to acquire economic independence and self-confidence. However, inequality in the distribution of household tasks among family members creates unlimited demands on women's time and energy, restricting their personal and business development.

Being able to get past these barriers necessarily assumes reordering, reassigning or transferring responsibilities to other people. These could be the husband, a paid (household) worker or a family member. It also assumes significant self-confidence and self-esteem, as well as more than usual equality and cooperation with the husband.

Modifying Products and Service Delivery

While it is important to continuously reduce transaction time for all microentrepreneurs, women's businesses in particular, are time-sensitive due to their other household duties. Time spent getting to or from a branch, in the branch or in a group meeting should be kept to a minimum.[6] In societies where women live in seclusion, however, time spent in meetings with other women should be promoted, provided it fits in with other demands on women's time.

Women want to see their financial services provider as a trusted advisor. They are more sensitive to good and bad customer service than men and expect their dealings to be more relational than transactional. Training in customer care should take this into account. Institutions focusing on the women's market will need to make customer service a core competency.

Women do not want different, "feminine" products such as pink checkbooks, but they generally do want more information before making a decision to purchase a financial service. This should also be integrated into customer service training for front-line staff, and marketing materials should explain service attributes and conditions clearly and transparently.

Some product categories, such as long-term savings products and insurance, require more explanation than others. Financial literacy training can be integrated into product marketing materials.

Lending and Savings Products

- The invention of the group loan mechanism by the Grameen Bank in Bangladesh in the 1970s was a breakthrough because it minimized the collateral required, enabling very poor people to borrow money. Individual loans, on the other hand, still require some form of guarantee. In general, women have less access to certain types of collateral such as land titles and they have less access to guarantors who have salaried jobs. Lenders should take this into account when designing products that target women.

- As this research has shown, households are not necessarily co-operative. Many women reported that as they increased their financial contribution to the household, their male partner reduced his. With this in mind, it is important to be sensitive to a woman's need for confidentiality from her financial services provider. Institutions need to think carefully before mandating that the husband's signature should be on the loan agreement. Likewise, with savings products, savers should be allowed to keep their balances confidential.[7]

- Products should be designed with the financial goals of the customer in mind. Think about their lifecycle events and their need to build assets and to manage risk.

- Since women are responsible for saving in most households, savings products should be designed with their realities in mind. Women save small amounts on a daily or weekly basis. They like the money to be collected from them and they like to save for specific goals. Research has shown that when people have a goal to save for, they are more likely to save.

- Savings products for particular life cycle events (goals) would include regular, small deposits over a fixed period of time, such as 12 months to pay for school fees, 36 months to provide collateral for a home improvement loan or 120 months for old age. The latter can be combined with insurance so that the ultimate lump sum goal is guaranteed for designated beneficiaries if the saver dies before maturity.[8]

- Loan products that cater to lifecycle needs such as housing (home improvement loans) are a vital part of the product mix. Some microfinance providers such as Grameen have mandated that the woman's name be on the property title in order to receive a loan. The extent of the need for this depends on the cultural context and the ability to do it cost-effectively depends on the legal context. When offering home improvement loans, this should be considered.[9]

- Risk assessment by credit officers tends to look more at flows of money than at stocks. This became evident when we examined Florentina's borrowing history in particular. We found that the credit officer had underestimated the value of her properties and the income that flowed from them. This led to an unnecessary rationing of credit. A larger loan, made available sooner in her asset-building trajectory, could have boosted her asset creation. Microfinance providers need to ensure that credit officers are adequately trained.[10]

- Emergency loans can be offered for unexpected shocks such as sickness or accidents.

- Consumption loans for household durables are valued by women, particularly if, like washing machines and gas stoves, they reduce drudgery.[11]

Microinsurance

- Gender roles mean women are expected to manage risk in most households. Affordable health insurance would reduce the vulnerability of poor households considerably, as would life insurance that minimizes the financial loss of the deceased on the family.

- As with all products designed for the poor or the rich, market research is an absolute prerequisite. Applying a gender lens to this research is also vital if products are to achieve optimum outcomes. For example, research in East Africa has shown that upon the death of a husband, a woman can lose assets that were jointly held with her husband to her husband's family. In this cultural context, in order to ensure allocation of the payout to women:

– The assets must be in the woman's name.
– Women must be designated as beneficiaries.
– Payouts should be made directly to a woman's account.[12]

- Research on microinsurance around the world also suggests that this product category needs to be supported with education for the customer in order for it to be adopted.

Marketing Strategies for Financial Services

To become the financial services provider of choice for women, institutions have to align their entire team around serving the woman customer. Customer research should be shared with the team to explain gender roles and responsibilities, aspirations, goals, and survival strategies. The team needs to be sensitized to the fact that there are different market segments among low-income people and needs to be aware of stereotypes about women and men's abilities to manage a business, to borrow and to make financial decisions.

- Products should be designed with a gender lens, as should product marketing strategies.

Childcare

- Aside from financial services, access to affordable childcare would be the single most important lever in helping women to grow their businesses. The microenterprise sector, civil society, governments and donors should work to develop a low-cost childcare business model that low-income women can own and that low-income children can attend. Women business owners would need to be supported by training and would be able to purchase materials with loans. Quality control would need to be carried out by a supporting agency.

- As of May 2006, ADOPEM had nearly 500 women who ran day care centers and kindergartens.

Business Development Services

- Many interviewees in this study had very limited visions for the development of their businesses. Microfinance providers could form strategic alliances with specialized business development service providers (BDS) to enable clients build up their capacity. Some microfinance providers offer training themselves, as does ADOPEM.

Health care

- As well as forming a strategic alliance with a health insurance provider, microfinance institutions can think creatively about how to effectively leverage their distribution channel to promote health education and access to health care providers.

***Inez Murray** is Vice President for Technical Assistance and Programs at Women's World Banking. Excerpted from* WWB GENDER STUDY: The Capacity of Poor Women to Grow Their Businesses in the Dominican Republic, *Copyright 2006, Women's World Banking (www.swwb.org).*

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[1] The exchange rate at the beginning of 2003 was $1 = 22 RD. This rate was used for the remainder of this report.

[2] In May 2002, when this research was conducted, the Dominican Republic had enjoyed a buoyant property market for several years. Thus, many interviewees chose to invest in housing, given its likely return. The macroeconomic decline set in motion by the collapse of Bank BanInter in May 2003 changed this strategy.

[3] Many couples choose not to get married formally. If they split up, the female partner is usually left with the house so that she can raise the children in it.

[4] This section was complemented by research conducted by WWB into the demand for savings conducted among ADOPEM's borrowers in March 2003.

[5] This is an interesting feature of some Dominican SANES, though not all, i.e., that the SAN organizer takes the first payout without contributing anything to the SAN itself. Thus, organizing SANES can be a lucrative business.

[6] Many MFIs around the world integrate training into group meetings. This should be optional for borrowers.

[7] An inexpensive alternative to passbook accounts are plastic cards with the account number printed on them. Savers can go into a branch and ask the teller to print out balances and previous transactions.

[8] An additional idea is 'matched' savings accounts. Increasingly common in developed economies (e.g., the US, Canada, the UK, Singapore), the central idea of these products is to encourage savings toward specific asset accumulation goals through matching the amount saved. Matching funds are supplied either by government, donors or the private sector. The match rate would be determined by the funder, e.g., 5:1 or 2:1. Depositors are free to deposit more than the minimum, but funders may limit their matches.

[9] In the Dominican Republic this did not seem to be an issue since women tended to be left the family home upon splitting up with their male partners. In other contexts such as Morocco, upon divorce women have a very limited chance of getting the family home and are left vulnerable as a result. Furthermore, research in Southern India found that the rate of domestic violence decreased from 45 percent of married couples to 10 percent when the family home was in the wife's name. By contrast, the fact that the wife was earning an income had no effect on the incidence of domestic abuse. Source: http://www.infochangeindia.org/bookandreportsprint44.jsp.

[10] Since this research, ADOPEM has introduced home improvement loans.

[11] Spandana, a microfinance institution located in Andhra Pradesh in India, figured out a solution to save women from walking three hours each day to get fire wood. The institution

negotiated with a manufacturer of two-ring gas stoves to get them to reduce the price of each stove by 50 percent and then negotiated a discount with the gas company to get the stoves connect to gas. Borrowers were offered a loan to pay for both the stove and the gas connection. Spandana reported that 60,000 women had signed up for the package within six months.

[12] *Reducing Vulnerability: The Demand for Microinsurance*. Journal of International Development, 17, Pages 37-474, 2005.

SOCIAL MARKET DEVELOPMENT AND SOCIAL MOBILIZATION

IN THE VALUE CHAIN OF THE CONSTRUCTION INDUSTRY

Inês Magalhães and Anaclaudia Rossbach

I. Background

For the first time, there is widespread growth in the consumer market due to an increase in the income of a social segment traditionally excluded from the formal markets. An indication appears in the major newspapers of a trend amongst some private sector executives to invest in or start businesses to reach out to the niche market characterized by low income communities.

Since 2007 intense debates have been taking place on the nature of the middle-class, greatly attracting the attention of media and society as a whole. The debates focused on changes in low income socio-economic groups as the result of higher employment rates and greater sources of income during this first decade of the millennium in Brazil.

A typical example in Brazil is the retail trade and financial agencies segment. These companies provide credit for consumer goods to low income families, compatible with their ability to pay. This development raised industry interest in developing products designed to meet the specific needs of low income consumers. However, market development in Brazil is traditionally linked to statistical instruments, such as prospective research on consumer demand with the aim of assessing potential preferences for products. Such special purpose consumer research studies are usually carried out by companies and skilled professionals on individuals from the middle social strata of the conventional consumer market. The preferences of low income people are still unknown in regards to many things.

Housing Introduction

The dynamics in the value chain of the construction industry have been underway since the late 1980s when the squatter settlements (favelas, illegal allotments and cortiços) set up in the 1970s underwent a spontaneous urban development with the replacement of dwelling houses made of inadequate construction materials with brick houses, and upper floors.

This urban development was greatly enhanced by social mobilization movements for better housing conditions for slum dwellers, like the Movimento de Favelas de São Paulo and pastoral services who advocated for access to water and electricity in some of the city's neighborhoods that had no formal acknowledgment.

At present, our precariously built settlements have means of access to water and electricity far better than their counterparts in African and Asian countries. Additionally the quality of the houses has improved significantly in the last thirty years, and it is very difficult to find a favela in the country made of wood or of low quality construction materials.

This improved framework is a result of the synergy between the government and social groups and has lead to an important interface with the private sector that has hardly been harnessed. Electricity and the construction materials are a typical example of how the private sector has benefited from social movement's initiatives.

For example, in the electricity sector (private sector today) there is a scheme of cross subsidies by which the middle-class finances the electricity social tariff, which is crucial to ensure the sustainability of the electricity network, as well as its potential expansion. The expanding market for electricity and construction materials is evidence of how the private sector has already benefited from social movement's initiatives.

Access to formal and regular electricity represents a significant improvement in low income people's living conditions, as it reduces the risks of fire and domestic equipments damage, allows access to electronic consumer goods, and strengthens social inclusion. Even if it is initially subsidized, a first access is another way of gaining a new client, and if the client's income rises, the client will no longer be subsidized and will contribute more to sales revenues.

Public investment due to advocacy from social movements has driven a trend towards housing quality improvements by encouraging the tendency of low income families to invest in, improve and expand their houses. This process has obviously taken place in a disorderly fashion lacking technical evaluation and planning in the public domain, leading to risky situations, excessive densification and material misuse.

II. The present value chain of the construction industry

The consulting company Booz Allen Hamilton carried out a study for construction materials associations. It showed that 77% of the residential units produced in Brazil are based on self-management[1] and are not built by the large construction companies. In other words, the largest consumer of construction materials in the country is the informal contractor who builds for himself or for others without resorting to financial products and subsidies.

Estimates performed by ANAMACO (Associação Nacional dos Comerciantes de Material de Construção) (National Association of the Building Materials Commercialization Agents) reveal that self-managed construction annually produces about 850 thousand units, 64% of which are produced through self-financing[2].

Despite the difficulties in determining accurate statistical data on the dynamics of the informal construction market, it may be inferred from simple visual perceptions that the present Brazilian favelas have masonry residential units that represent a significant improvement from the time before the 1990s. Nevertheless, even without carrying out field research it can also be seen that the families plan to improve and enlarge their units, as many are clearly unfinished, lacking outer finishings indicating an upper expansion of the units. That is: it is a market with a great expansion outlook.

Some companies, in a very creative way, have been working on the development of specific products for the low-income housing market; this is the case, for instance, with the BRASKEM petrochemical company. BRASKEM, a producer of PVC, has been investing significant resources towards the development of products such as frames, bathrooms and entire houses from constructive PVC technology. One of the research branches of the company focuses on assessing consumer satisfaction based on surveys carried out with consumers from favelas and low-income housing units.

It is imperative to distinguish between what is considered to be low income housing by the private sector and the bottom of the income pyramid in Brazil. The Getúlio Vargas Foundation (Fundação Getúlio Vargas) has recently released a study that defines the “new middle-class”, the middle economic strata represented by families with an income ranging from R$ 1,064 to R$ 4,591. 51.9% are in this income bracket. However, the Pesquisa Nacional por Amostra de Domicílios – PNAD reveals that households with an income lower than this bracket represent about 40% of the total.

That is: the middle income strata has growing purchasing power, but the bottom of the pyramid with low purchasing power is still significant and should not be ignored.

The supply of residential housing by the formal market is still in its initial stages. It is a market in need of development and maturing, since the final cost of the property and the maintenance costs of the products supplied are still very high. In the middle strata, households with an income range of 1,000 to 4,000 reais still have to deal with limited long-term borrowing capacity and low savings, which are obstacles to asset acquisition. Regardless, houses available through the formal market are closer to the lifestyle and preferences of the traditional middle-class than the needs and preferences of the low-income housing market.

Accordingly, it can be argued that the construction materials market is larger than the formal real estate market. The construction materials market can serve people in the majority of income brackets, from the slum dweller who buys material to build or enlarge his house, to those in the upper economic population strata; the formal housing market is only trying to target the middle-class.

III. The social organization potential of demand prospecting

At present, the large social movements associated with housing have focused on housing provision to meet demand, rather than specific matters pertaining to urban infrastructure improvement. Additionally, with the expansion of the democratic management processes of the cities, the main movements started to intervene intensely in government policies through mechanisms such as housing committees and participatory budgeting.

These organizations expanded across the country and are represented in several councils and bodies of participatory management and formulation of public policy. They bring together a significant number of low income families with expectations of access to housing.

Alongside these national organizations that traditionally act on matters related to housing, community mobilization initiatives have emerged, operating in specific locations. They work on gathering information and resources about the community as the key strategy in promoting social and economical development.

For instance, the main goal of SDI – Slums Dwellers International in Brazil is to improve housing conditions by organization and community mobilization, especially through savings community groups and self-enumeration.[3] Through self-enumeration the residents of a community have a better chance of getting to know the geographical features of the place where they live, as well as the socio-economic conditions of the households.

The information gathering carried out by the community itself is an important driving force of organization and community mobilization, in addition to providing an important input for grant negotiations and housing projects. Savings groups situated in the municipalities of Osasco and Várzea Paulista, in the Greater São Paulo area have already demonstrated positive results in negotiation with their local governments. This has resulted in infrastructure projects and production of housing units, in addition to units such as crèches, health care surgeries and community centers.

The savings groups are still very recent in Brazil, but have shown in other countries a high potential to generate housing projects in partnerships with governments and in some cases with private sector companies.

The larger social movements in Brazil participate in broader negotiations with several levels of government. This is the case with the Social Housing Program of the Federal Government, a housing provision program that is jointly structured with the social movements, Ministério das Cidades (Ministry of Cities) and Caixa Econômica Federal (publicly owned bank, financial agent for the Federal Government). In an unprecedented way this program uses information provided by social movements to design a housing program to suit the dynamics of communities.

IV. Conclusion

There exists an enormous potential to develop housing projects based on inputs provided by social movements. So far, in Brazil, the information held by social movements has been strongly encouraging government actions with little resort to market forces.

Demographic projections carried out by the Ministério das Cidades and CEDEPLAR - Centro de Desenvolvimento e Planejamento Regional (Universidade Federal de Minas Gerais), point to an estimated 26 million new homes needed by 2023. Of this, 60% is represented by segments presently excluded from the formal housing market. This niche constitutes the target audience for the main social movements that fight for housing rights in Brazil, and a potential new market for innovative private sector actors.

We have seen that in Brazil, the social movement's advocacy for improved housing conditions has contributed in an indirect way to private market expansion, namely in the electricity and construction sectors. By recognizing the potential represented by the information on families, consumer dynamics, needs and preferences that are held by social movements, social organizations can actively contribute to market expansion. By providing access to this insight, social organizations enable companies to generate revenue and improve living conditions, triggering a virtuous circle for society and the economy as a whole.

There is a pressing need for the market to adapt to the characteristics of populations attempting to integrate into the formal economy; the adjustment may take long. Our fundamental claim is that the market adjustment to serve low-income consumers can be successful at significantly higher speed if it is based on the mobilization and information gathering potential of social organizations, and reaches out to the government, whose investments and incentives may propel further expansion of the market and social sectors.

Linking people's movements and the market can indeed promote superb synergies that will lead to market expansion, product development and technological innovation. The alliance of social movements and private sector will become more important over the third millennium. Although achievements have been made to influence public policies, there is still a lot to be done.

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[1] Source: http://www.anamaco.com.br/dados_setor.php
[2] Source: http://www.anamaco.com.br/dados_setor.php
[3] Translation Note: *Auto-recenseamento*: Self-enumeration refers to the completion of census survey questionnaires by the respondents themselves

UNDERSTANDING ASIAN CITIES:

A SYNTHESIS OF THE FINDINGS FROM EIGHT CITY CASE STUDIES

David Satterthwaite

Forward: An introduction to understanding Asian cities

The decision for creating the Asian Coalition for Housing Rights (ACHR) was taken in 1987. Its founding members were professionals and NGOs working with poor communities in Asian cities. The organization was formalized in 1989 in Bangkok. Conditions at the local and international level at that time were very different from what they are today. The ACHR senior members have been very conscious of this reality and as a result have, over the years, stressed the need for understanding the changes that have taken place in the last decade and a half in Asian cities.

As a result, it was decided in the first quarter of 2003 to carry out a research on a number of Asian cities, so as to identify the process of socio-economic, physical and institutional change that has taken place since the ACHR was founded; the actors involved in this change; and the effect of this change on disadvantaged communities and interest groups. Eight Asian cities and eight researchers were identified for the purpose of this research. The case study cities are: Muntinlupa (a municipality in Metro Manila), Beijing, Hanoi, Phnom Penh, Chiang Mai, Surabaya, Pune and Karachi. The objectives of this research and the terms of reference for it are given on page 2, along with the names of the researchers. All of the researchers did not strictly follow the terms of reference. However, an enormous amount of material, running into hundreds of pages, regarding these cities has been generated and is available with the ACHR secretariat. The research and logistics related to the Asian cities project have been funded by the German funding agency Misereor.

During the period of the research, a number of meetings were held for discussions between the researchers. An introductory meeting was held in Bangkok in June 2003, followed by additional meetings in Bangkok and Hanoi. At these meetings, researchers presented the findings of their research and identified differences and similarities between these cities. A final meeting was held in Bangkok in October 2004. David Satterthwaite, from the International Institute for Environment and Development (IIED) in UK, was requested to facilitate this final meeting and to prepare a synthesis of the findings of the eight city case studies. This synthesis forms the subject of this publication.

The research has identified many differences between the eight cities. However, there are a number of strong similarities which are the result not only of how these cities have evolved historically but also of the major changes that have taken place in the world in the 1990s. These changes are the result of structural adjustment, the WTO regime and the dominance of the culture and institutions of globalization in the development policies (or lack of them) at the national level.

The most important finding of the report is that "urban development in Asia is largely driven by the concentration of local, national and increasingly, international profit-seeking enterprises in and around particular urban centers" and that "cities may concentrate wealth both in terms of new investment and of high-income residents but there is no automatic process by which this contributes to the costs of needed infrastructure and services". The more negative aspects of the changes identified in the reports that adversely affect the lives of the more disadvantaged groups in Asia's cities are given below:

1. ***Definitions of what is urban are determined by political considerations*** that seek to support the political and economic status-quo, in favor of more powerful sections of society.

2. ***Globalization has led to direct foreign investment in Asian cities, along with the development of a more aggressive business sector at the national level.*** This has resulted in the establishment of corporate sector industries, increased tourism and a rapid increase in the middle classes. Consequently, there is a demand for strategically located land for industrial, commercial and middle class residential purposes. As a result, poor communities are being evicted from land that they occupy in or near the city centers and are being relocated, formally or informally, to land on the city fringes, far away from their places of work, education, recreation and from better health facilities. This process has also meant an increase in land prices due to which the lower middle income groups have also been adversely affected.

3. ***Due to relocation, transport costs and travel time to and from work have increased considerably.*** This has resulted in economic stress and social disintegration as earning members have less time to interact with the family.

4. ***Due to an absence of alternatives for housing, old informal settlements have densified***, and as such, living conditions in them have deteriorated in spite of the fact that many of them have acquired water supply and road paving.

5. ***An increase in the number of automobiles in Asian cities has created severe traffic problems*** and this in turn increases time taken in travel, stress and environment related diseases. New transport systems (such as light rail) that have been or are being implemented do not serve the vast majority of the commuting public and in most cases are far too expensive for the poor to afford.

6. ***As a result of structural adjustment conditionalities and the culture of globalization, there are proposals for the privatization of public sector utilities and land assets.*** In some cities the process has already taken place. There are indications that this process is detrimental to the interests of the poor and disadvantaged groups. An important issue that has surfaced is the question of how the interests of the poor can be protected in the implementation of the privatization process.

7. ***The culture of globalization and structural adjustment has also meant the removal or curtailing of government subsidies for the social sectors.*** This has directly affected poor communities who have to pay more for education and health. In addition, private sector involvement in education, both at school and university levels, has expanded, creating two systems of education: one for the rich and the other for the poor. This is a major change from the pre-1990s era and can have serious political and social consequences for the future, especially since the largest section of the population of Asian cities is young, increasingly better-educated and with aspirations that cannot be fulfilled by unjust political and social systems.

8. ***As a result of these changes, there has been an enormous increase in real estate development.*** This has led to the strengthening of the nexus between politicians, bureaucrats and developers, due to which building bye laws and zoning regulations have become easier to violate, and due to which the natural and cultural heritage assets of Asian cities are in danger or are in the process of being wiped out.

9. ***There are multiple agencies that are involved in the development, management and maintenance of Asian cities.*** In most cases, these agencies have no coordination between them. In addition, in most cities there are central government interests that often override local interests and considerations.

However, the city case studies also bring out a number of positive changes and trends that have taken place or are taking place now. Some of the more important changes are given below:

1. ***Over the last two decades, urban poor organizations have emerged in most Asian cities.*** These organizations are backed by professionals and/or NGOs. Where they are powerful, governments are forced to negotiate with them. Their involvement in the planning and decision-making process is increasing.

2. ***Civil society organizations have successfully come together in a number of cities*** so as to put pressure on governments for the development of more equitable development policies and/or to oppose insensitive government projects.

3. ***There are now a number of government-NGO-community projects and programs.*** It is true that the lessons from these programs have yet to become policies in most countries, but the lessons learnt from them have been understood and appreciated by politicians and city planners whose attitudes to the disadvantaged urban populations have changed considerably since 1987 when the ACHR was formed.

4. ***In all the case study cities, there has been a process of decentralization.*** This has opened up new opportunities for decision-making at the local level and for the involvement of local communities and interest groups in the decision-making process. In some cases, this has also meant a weakening of the community process in the face of formal institutions at the local level. In this regard, this synthesis paper asks two important questions: *Does*

decentralization give city governments more power and resources and thus capacity to act? and If city government does get more capacity to act does this actually bring benefits to urban poor groups?

The ACHR partners have to discuss the issues that the case study synthesis paper has raised. They have to see how the negative aspects that the case studies have identified can be minimized and how the positive aspects can be supported and promoted. In Asian countries, there are now enough examples from which one can learn and which relate to both the positive and negative aspects identified above. How can one increase this learning process? The ACHR partners are important people and institutions in their countries both at the city and national level. They have like-minded friends in academia and in multilateral and bilateral development agencies, and the ACHR itself is respected in the development world. This was not so in 1987. The ACHR needs to reflect on how all these positive aspects can be brought together to promote not just projects and programs but policies that can create a more equitable society in Asia.

(Forward by Arif Hasan, September 15, 2005)

Introduction

Asia's urban centers house around 1.5 billion people. A quarter of the world's population and around half its urban population. By 2025, around a third of the world's total population is likely to live in Asia's urban centers. Thus, how these centers function and serve their populations has great significance for a large part of the world's population.

Asian urban centers also have most of the world's urban poverty, most of its 'slum and squatter settlement' population and most of the urban population that lacks adequate provision for water, sanitation, drainage and good quality health care and schools. Thus, how Asian urban centers function also has major implications for whether poverty is reduced and international development targets such as the Millennium Development Goals are met.[8] But Asia also has many of the most innovative responses to such problems, including some that have been implemented on a scale that show how it is possible to combine rapid urban development with improving living standards for lower-income groups.

Asia also has a large and growing concentration of the world's largest cities - and here too, there are significant examples of innovation in local governance and urban management. Asia has half the world's 'million cities' (cities with one-million or more inhabitants) and more than half of its 'mega-cities' (cities with ten million or more inhabitants). The concentration of the world's urban population in Asia and of its largest cities reflects the region's large and increasing role within the world economy. Asia's urban centers contain a considerable part of

[8] The Millennium Development Goals are a set of eight goals and 18 targets to which most international agencies and national governments have committed themselves. The targets include major reductions in poverty, ill-health and premature death by 2015 and large improvements in provision for schools, health care, water and sanitation. Also significant improvements in the lives of at least 100 million 'slum' dwellers by 2020.

all new (domestic and foreign) investments made over the last 30-40 years, although this is concentrated in relatively few cities in a few nations. Asia has seven of the world's 20 largest economies, including the second, third and fourth largest (China, India and Japan).[9]

Most Asian nations are also much more urbanized than they were twenty or thirty years ago (i.e. with a much higher proportion of their national population living in urban centers). This reflects the much increased role of urban-based enterprises in their economies. Almost all Asian nations now have more than half their GDP produced by industry and services, most of which is concentrated in urban areas. In general, the higher a nation's per capita income, the more urbanized its population. Also, the more rapid its economic growth, the greater the increase in the proportion of their population living in urban areas. Thus, there is an economic logic underlying most urban change. Asia's largest cities are heavily concentrated in its largest economies (*see table below*).

However, this major role for Asian cities within the world's urban population is not something new; for most of recorded history, Asia has had most of the world's urban population and most of its largest cities. Most of Asia's largest cities also have long histories. More than two thirds were already important cities 200 years ago; more than a quarter were founded more than 2000 years ago.

Table: The distribution of Asia's largest cities among its largest economies in 2000

Nations (listed by the size of their economy in 2000/2001)	***No of 'million cities'***	***No of cities with 5-9.99 million inhabitants***	***No of mega-cities (with 10 million plus inhabitants)***
China	90	3	2
Japan	6		2
India	32	3	3
Republic of Korea	6	1	
Indonesia	6		1
Turkey	5	1	
Iran	6	1	
Thailand	1	1	
Philippines	2	1	
Pakistan	7		1
Saudi Arabia	3		
TOTAL FOR ASIA	194	13	10

SOURCES: For population statistics, United Nations (2004), *World Urbanization Prospects: The 2003 Revision*, United Nations Population Division, Department of Economic and Social Affairs, ST/ESA/SER.A/237, New York. For the size of nations' economies, World Bank (2001),

[9] This is based on calculations of the size of each nation's economy, based on GNP figures adjusted for purchasing power parity.

Building Institutions for Markets; World Development Report 2002, Oxford University Press, Oxford, 249 pages.

Asia also has many of the world's fastest growing large cities, both over the last few decades and during the 1990s (the latest period for which there are census data for most Asian nations).[10] However, over the last two decades, there has also been a notable deceleration in most major cities' population growth rates. Many of Asia's largest cities have slow population growth rates. One important reason, for most cities, is much reduced rates of natural increase. For successful cities with low rates of natural increase, this means that net in-migration becomes a more significant source than natural increase in the population growth - as, for instance, in Hanoi and many successful Chinese cities. However, natural increase still accounts for most of the growth in Asia's urban population.

Another reason for slower population growth in many major cities is that, especially in the larger Asian economies, they are facing competition from smaller cities for new investment, and this is producing more decentralized patterns of urban development - just as it has done so in other regions.[11] More than half of the 194 Asian 'million cities' had population growth rates of less than 2 percent a year during the 1990s and some had population declines. Only 12 had population growth rates of 5 percent or more a year during the 1990s.[12]

Unintended cities

The tens of thousands of urban centers in Asia have certain obvious shared characteristics - a concentration of people and their homes combined with a concentration of enterprises that provide income-earning opportunities. All have some form of 'government' body, virtually all have some public services (for instance schools, health services). The larger urban centers generally have higher concentrations of government employees and services. These are also characteristics that Asian urban centers share with virtually all urban centers in other regions. Indeed, most governments define urban centers by one or more of these criteria: a minimum population threshold, status as a local government centre and a concentration of non-agricultural employment or density above a defined threshold (often faulty definitions for political reasons).

Although all urban centers may share certain social, economic and physical characteristics, in another sense they are all also unique - produced by their own unique local physical/ecological,

[10] United Nations (2004), World Urbanization Prospects: The 2003 Revision, Population Division, Department for Economic and Social Affairs, ESA/P/WP.190, New York, 323 pages.

[11] See for instance how in the USA, cities such as Los Angeles, Houston, Dallas, Miami and Phoenix grew to compete with the older large cities in the Northeast; in Mexico, the cities in the Northeast that compete with Mexico City; in Brazil, the cities in the Southeast attracting new investment away from Sao Paulo and Rio de Janeiro.

[12] Note that very large cities can have relatively low population growth rates yet still have large annual increments in their population. Annex Table 2 lists the annual average increments in city populations during the 1990s, as well as their compound growth rates - so, for instance, cities such as Calcutta/Kolkota and Manila had relatively slow growth rates but still had a city population that grew by an average of around 200,000 inhabitants a year during the 1990s.

economic, social and political context and the interaction there of local and extra-local influences. What actually developed within and around each urban centre was in large part unintended. When some Hindu merchants founded Karachi in 1728, they did so for obvious pragmatic reasons - the port they were using was silting up. They produced an urban centre by investing in productive activities there (a port and other facilities) and this attracted other people and investments. They did not foresee that the port they founded would become one of the world's largest cities. Subsequently, in deciding to use Karachi as a port and a military base, the British may have made provisions for their troops and civil servants but they did little for the growing population attracted to Karachi by employment prospects. And Karachi's development, like those of virtually all major cities, was much influenced by factors far beyond the control of those who lived there.

BOX: Karachi: ***The interplay of local and international influences on the city's development . . .***

Karachi's origin is as a port, set up in 1728 by Hindu merchants because their existing port was silting up. Its early growth in early 18th century was underpinned by its role as a transit trade route between the Indian peninsular, Central Asia, Africa and Eastern Europe. In 1839, it was occupied by the British and used to land troops and armor for campaigns in Afghanistan to contain the Russians. In 1843, the British annexed Sindh to their empire and Karachi became an important administrative centre. Its role as an export port increased greatly when a railway linking it to the agricultural areas of the Punjab was completed in 1870. Czarist and later Soviet pressure on the western frontier of British India increased Karachi's importance as it became a strategic naval and army base.

During World War 2, it became a landing port for troops and materials of the eastern front. In 1947, it became the first capital of independent West Pakistan and received 600,000 refugees from India between 1947-1951. In 1958, it lost its status as national capital, as Islamabad was developed. It received further very large waves of migrants during and after the war that led to East Pakistan becoming Bangladesh and then during the civil war in Afghanistan, as it became a major centre for Afghan refugees (some 600,000 of whom settled in Karachi) and a landing point for munitions. It was also a key port and organizational centre for when, in 2001, the Pakistan army joined the USA in its war on terror in Afghanistan (in spite of civil society and populist objections).

Inevitably, the very large population movements into Karachi brought many political conflicts - including those between long-term city dwellers and immigrants from India, between Pakistanis and Afghans, and between urban interests and rural interests. In recent years, structural adjustment programs, privatization and the removal of trade barriers, all promoted by international agencies, have had major impacts in Karachi - for instance the decline in many industries unable to compete with cheap Chinese products and the rapid increase in prices for water, sewers, health care, electricity and transport.

In addition, once a city has been founded and has developed a concentration of residents and enterprises, it is rare for it to cease being a city, even though it (or the nation or region within which it is located) undergoes very large social, economic and political changes. Once a city has developed, it concentrates economic and political interests that are tied to it and committed to its future success.[13] As a city develops, so too does the demand for goods and services it concentrates and the transport and communications networks that connect it to other places and give it some comparative advantages over other locations that lack these. Cities that were formed primarily as political/military centers often attract new investments in industry and services, so the political role that underpins the city is enhanced (and sometimes overtaken) by an economic role.

The Indian city of Pune developed first as a cultural capital for its local population - and in part because of its strategic location (on a ford across the river) - and later developed as an important administrative centre under colonial rule. But its rapid growth in recent decades owes more to its success in attracting new enterprises than to its political role, as it has become one of India's most important industrial and service centers. Chiang Mai's origins are as the capital of the Lanna Kingdom, established over 700 years ago, and although the factors that underlie its economy have changed much since its foundation, it has always been an important city. Chiang Mai is now not only an important tourist centre but also the main administrative, financial, trading and educational centre for the northern region of Thailand.

The contractions within cities

Cities grow as private investment concentrates there. But there is no automatic development of any capacity to govern the city and ensure that growing populations and economic activities can get the land, infrastructure and services they need. Cities may concentrate wealth, both in terms of new investment and of high-income residents, but there is no automatic process by which this contributes to the costs of needed infrastructure and services.

Two characteristics shared by most Asian urban centers are the inadequacy in provision for the basic infrastructure and services needed in all residential areas - including provision for piped water, sanitation and drainage, roads, schools, electricity and health care - and the poor quality of the housing for large sections of the population. UN estimates suggest that in 2000, more than 500 million urban dwellers in Asia lacked adequate provision for water and more than 600 million lacked adequate provision for sanitation.[14] Asia contains most of the world's urban population living in slums and squatter settlements.[15] In many Asian urban centers, a high proportion of the population lives in illegal (informal) settlements where the inadequacies in provision for infrastructure and service are usually worst. Again, there is great variation between cities in the proportion of the inhabitants living in poor quality housing lacking infrastructure and services, in the form these illegal (informal) settlements take and in the extent to which their inhabitants are at risk from forced evictions. There is also great variation

[13] There are exceptions - for instance mining towns and towns developed to exploit forests that decline, once the resource base on which they depend depletes.
[14] UN-Habitat (2003), Water and Sanitation in the World's Cities; Local Action for Global Goals, Earthscan Publications, London, 274 pages.
[15] UN-Habitat (2003), The Challenge of Slums: Global Report on Human Settlements 2003, Earthscan, London.

in regard to whether conditions have improved or got worse. But in very few Asian cities can the majority of their lower-income population find reasonable quality, secure accommodation with basic services.

All cities and most smaller urban centers face a contradiction between what drives their economic development (and the in-migration this generates) and what contributes to adequate accommodation for the workforce on which they depend. Urban development in Asia is largely driven by the concentration of local, national and, increasingly, international profit-seeking enterprises in and around particular urban centers.[16] This in turn produces a concentration of people who work there or who seek work there and their families who have obvious needs for housing with infrastructure and services. But many of these people get low incomes and thus limited capacity to pay for housing and services. The larger the concentration of new investment, the greater the competition for the best located sites between non-residential (commercial, institutional and some industrial demand) and residential demand; the increasing concentration of households with high-incomes also pushes up housing and land-for-housing prices. Thus, large sections of the urban population that have low incomes seek accommodation within cities whose land-markets in all but the worst locations price them out of conventional housing markets - whether as tenants or as prospective owner-occupiers. The more unequal the income-distribution between households, the larger the proportion of households that have incomes too low to be able to pay much for housing. Low-income groups can seek accommodation in less convenient (cheaper and usually peripheral) locations, but are constrained by the time and monetary cost of getting to and from income-earning opportunities. In most Asian cities, there is no legal housing or land-for-housing they can afford that still allows them access to income-earning opportunities.

BOX: The commercialization of land in Phnom Penh:

For instance, in Phnom Penh, the demand for land has grown rapidly driven by commerce, foreign corporations, international tourism and middle and upper income households' demand for housing and all land in good locations is being purchased by the private sector and developed or kept for the profits that rising land prices bring. Almost all this land is government land but it is being sold off because of pressure from a powerful nexus of politicians, bureaucrats and local and international developers. This means few if any possibilities for lower-income households to find land on which they can build housing in central locations and great pressure from this nexus to evict those living in most centrally located informal settlements as the land on which they are located increases in value.

The enterprises that concentrate in and around urban centers produce no solutions to this contradiction of housing and land markets that are too expensive for large sections of the population, including those on whose labor and small-businesses these enterprises depend.

[16] Political change is often a powerful influence on urban development and was probably the most powerful influence for most Asian nations, when they gained independence from colonial rule, as the very structure of government was reformed and much expanded (with this expansion having a strong influence on expanding urban populations) - but now, in most Asian nations, it is economic change that has the dominant influence on urban development.

Indeed, the more successful a city is in attracting new concentrations of private investment, in general, the greater this contradiction. In the absence of effective local governance, this contradiction is usually 'solved' by large sections of the city population either sharing accommodation in existing buildings which produces extreme overcrowding and many three-generation households (and settlements that are often referred to as 'slums') or developing homes and neighborhoods illegally, either on illegal subdivisions or on land they occupy illegally.

There are many measures that governments can take to lessen this contradiction. For instance good quality public transport systems, measures to keep down land-for-housing and infrastructure costs, and financial support for households and communities in acquiring land and developing homes including support for negotiated solutions between those living in informal settlements and land-owners. But there are obvious political and often economic limits on the extent to which these can be implemented. Even if city governments (or communities) can acquire land, they usually have to pay full market rates. Obviously, there are powerful real estate interests that oppose any government intervention that may reduce or put at risk their profits from real estate markets. In addition, in all successful Asian cities, there are strong pressures to expel low-income groups from central locations, because of the demands from commercial and financial interests to improve infrastructure or because of the profits that would be generated by their redevelopment.

In regard to extending and improving service provision, some government body is usually responsible for ensuring provision of such services as water, sanitation, drainage, garbage collection, schools, health care and electricity. These government bodies generally ignore all these 'illegal' settlements or provide very inadequate provision (for instance a few standpipes and perhaps public toilets). These government service providers may not be permitted to provide services in informal settlements. Where provision for some of these services has been privatized, the privatized utilities rarely extend provision to informal settlements; even if they are allowed to do so, there is not much profit in doing so and the terms of privatization agreements rarely have conditions demanding that they do so.

This contradiction between what drives city development and what ensures adequate provision for its population has been further increased by globalization - both by local and national forces eager to make cities more competitive and to attract new investment and by the changes promoted or demanded within low- and middle-income nations by international agencies, including the World Bank, the IMF and the WTO. It is widely accepted now that all nations need to develop some comparative advantage within the world economy and that good economic performance (and some success in attracting foreign investment) is a key part of this. Inevitably, the investments that produce such economic success are concentrated in or around cities - but it does not necessarily produce the political and institutional means to address the contradiction between local economic success and the housing, infrastructure and service needs of the local population. Indeed, it often increases it.[17]

[17] This is not to suggest that market forces do not have key roles in helping to resolve this contradiction - as will be discussed later.

Public goods

As cities grow - i.e. as enterprises, institutions and people concentrate in space - so there is also an urgent need to protect public goods - public space, the quality of the environment (for instance through pollution control), law and order and the protection of each city's built and natural heritage (and many Asian cities have a very rich historical heritage). The redevelopment of sites that are already occupied and that involve relocating those who live there is also often justified as being in 'the public good' especially if these sites are considered to be 'slums' by city governments. But it is rare for much account to be taken of the 'public good' of those who are forced to move. Ensuring that the protection of the public good also serves those with limited incomes is also politically difficult, especially for low-income groups living in informal settlements in central locations that governments and developers want to clear for redevelopment.

For instance, in Pune there was a large relocation program to move families living in 'slums' close to the inner city to peripheral locations. This was justified by claiming that these settlements were contaminating a canal. But it was not only the settlements slated for relocation that produced this contamination and the contamination they produced could have been solved easily and far more cheaply by installing provision for sanitation. In fact, the clearance was not for the public good but because of a combination of anti-poor attitudes within government and the valuable real estate that would be made available as these people were pushed out. As will be discussed in more detail later, large-scale evictions are increasingly common in Asian cities and most evictions are justified for the 'public good' or the 'national interest' when actually the benefits are heavily concentrated among the richer and more powerful groups and the costs borne by the (mostly) poorer groups forced out of their homes and away from their livelihoods.

A city's historic heritage may also not be considered by something worth protecting by developers and most of those in government - as is evident in Beijing, in recent years, through the loss of the historic central city residential districts to redevelopment. Alternatively, a drive to protect a city's historic heritage may also seek to drive out 'the poor.'

Cities need governance systems that have the capacity to address these issues, including being able to broker agreements in which everyone's interests are addressed. This must also include agreements that involve lower-income groups and that meet their needs.

The actors that should contribute to solutions

It is assumed that governments should address the fact that formal urban land markets exclude large sections of the population from legal housing and infrastructure. This includes changing the ways that government rules, procedures and investments act to increase the price of land for housing. In some cities, governments have done so with considerable success - for instance by a series of direct and indirect measures that help increase the supply and keep down the price of land for housing in locations that serve lower income groups. These measures include efficient financing of and investment in infrastructure and services (which increase the supply and lower the cost of serviced plots for housing) and support for housing construction designs and methods that serve lower-income households. But in most Asian cities, they have not done so. The rest of this paper explores this contradiction between the market forces that drive most city development (and the concentration of people there) but that do not, of themselves, contribute much to the mechanisms for ensuring that this same concentration of people have their needs met for housing, infrastructure and services.

In one sense, markets do provide some kind of 'solution' because virtually all low-income households find some kind of accommodation and get some access to services. But most such housing and service provision is of very poor quality and helps underpin high levels of premature death and high disease and injury burdens. There are generally high levels of overcrowding. Most of this land development is illegal, so the inhabitants are often at risk of eviction, unable to get infrastructure and may be denied access to public services. Much of the land that is occupied in these ways is dangerous (for instance on sites at risk from floods or landslides or right beside railway tracks).

Where there is no formal provision for water, schools and health care, informal private sector providers are often important for low-income households. But such services are usually of poor quality, reflecting the very limited capacity of residents to pay for these. As the case studies on Phnom Penh and Karachi describe, informal markets have provided the 'solution' for housing for low income groups - including not only the land but often the housing, the building materials, the transport services and local financing mechanisms. In Hanoi, there is a large informal market for land and housing that operates through the sale of housing possession, since the occupier does not own the land or the house.

Governments need to recognize why these informal systems, with their many illegal aspects, produce land for housing and services at prices that large sections of the low-income population can afford, while formal systems do not. It is also important for many low-income households to be in settlements where their houses can be built and expanded incrementally, because they cannot afford complete, legal houses or the cost of constructing a complete house. This also helps highlight how government rules, regulations and procedures and government's failure to expand infrastructure networks elevates the price of legal land for housing, forcing so many households to move to illegal markets. But as examples given later will show, governments can make these informal processes work better - producing better quality housing and services and allowing a much increased proportion of the low-income population to get legal accommodation and legal access to infrastructure and services. This includes allowing civil society organizations (especially those formed by the urban poor) more scope in developing legal housing solutions for themselves and even developing partnerships with government to do so.

In addition, as informal land for housing markets becomes increasingly important, including the means by which many non-poor households get land for housing, the price of this informal land increases too, so even low-income households are being increasingly excluded. For instance in Karachi, during the 1980s, most low-income households could get land for housing, and the government's investment in serviced sites and infrastructure expansion helped keep down prices. But now land prices in squatter settlements and illegal subdivisions have gone up so much that most low-income households can no longer afford to purchase land there.

The discussion in the following sections consider how governments are addressing these issues, drawing on case studies in Beijing, Chiang Mai, Hanoi, Karachi, Muntinlupa, Pune, Phnom Penh and Surabaya. This discussion pays particular attention to the influence of city governments, civil society and external (international agencies). For city governments, the interest is in changes in their approaches to addressing this contradiction, including those that are largely the result of or depend on national government initiatives - for instance for decentralization and local government reform. For civil society, the interest is in what civil society organizations have developed to represent the needs of those whose housing, infrastructure and service needs are not met by formal systems and the nature of their relations with city governments.

Certainly, one of the most important trends in city development in Asia over the last two decades has been the emergence of organizations formed by the urban poor that increase their influence on city-government and, where political circumstances permit, form powerful and effective partnerships with local governments to reduce the cost and increase the supply of housing and infrastructure and to make legal housing more affordable. In discussing the eight city case studies, there is a particular interest in better understanding the extent to which urban poor organizations can become more influential in getting more pro-poor development and less anti-poor development at city level. This implies more influence not only on government but also on moderating anti-poor market pressures. Consideration is also given to the current and potential role of international aid agencies and development banks, both in their role in promoting or supporting global changes (especially globalization) and in addressing poverty reduction in urban areas.

How poorer groups manage to get housing outside the formal systems

In the case-study cities, as in most cities in Asia, large sections of the low-income population cannot afford the cost of legal housing and have to find or build their own accommodation outside formal, approved housing and settlements (see box below). In Karachi, the largest of the case study cities, with over 10 million inhabitants, more than half the housing stock is in squatter settlements or illegally developed informal settlements. In Pune, Muntinlupa and Chiang Mai, around two fifths of the population live in unauthorized settlements. In Beijing, it is not so much the market as government systems that exclude a large proportion of the population from legal housing - some 3.8 million 'unregistered' inhabitants cannot acquire or rent housing legally in that city.

In all cities, there is a powerful nexus between formal sector developers, politicians and bureaucrats which profits greatly from land developments and which opposes any land policy that would better serve low-income groups. This is even the case in cities where much of the land is under public ownership. For instance in Karachi, this nexus acquires not only vacant land, but even land that has been set aside for recreational and amenity purposes and its developments encroach onto land that was set aside for infrastructure. In addition, government land and properties are often sold at far below their market value through political patronage and then the developers make a 'joint venture' with the party. In Pune, there is a long-established process by which land that had been earmarked for housing for low-income families or for public amenities is reallocated to real estate developments. In both Pune and Karachi, through this nexus, developers are able to violate bye-laws and zoning regulations. In Karachi, as in most other Asian cities, there is also a profitable informal land development process; in Karachi, this is undertaken on government land with the benefits shared between the middlemen that undertake these illegal developments, government officials, the local police stations and local politicians.

In Muntinlupa, there are a range of groups that benefit from informal land markets, including not only the illegal land developers but also people and institutions that are part of law enforcement agencies, including chiefs of police and the land developers' allies in the official bureaucracy, including judges and prosecutors. Despite the illegality of these informal markets and the fact that it is richer groups that gain most from them, they have made land and housing more accessible to lower-income households. The system is sufficiently well developed for there to be informal rules on who gets rights, from whom and how and this creates a sense of order in informal settlements. In many informal settlements, basic service provision has been negotiated by the residents - for instance through water mainly by deep wells supported by politicians or local government. Some urban poor communities have negotiated to get legal electricity supplies. Many urban poor communities have learned to negotiate with private service providers, landowners and authorities for incremental improvements of their neighborhoods.

The fact that large sections of the low-income population develop their homes on dangerous or unsuitable sites (for instance along railway tracks or river bank sites prone to flooding) is not necessarily due to any shortage of more suitable undeveloped land sites - as is evident in Chiang Mai, Pune, Muntinlupa and Phnom Penh. In Phnom Penh, a land availability study found sufficient undeveloped land within the city to allow for relocations of those displaced by infrastructure projects. In Muntinlupa, there is sufficient government-owned vacant land in good locations to allow many of those living on land that cannot be upgraded to be rehoused - but the government agency that owns this land wants full market value for it, which makes it too expensive for the city authorities to use. Even if government measures are in place to acquire land for low-income groups, as in Muntinlupa (supported by the national Community Mortgage Program), landowners still get market rates for compensation.

In Hanoi, much of the poor quality housing is a legacy of housing stock built with government funds under central planning that was allotted to workers and public employees of plants, enterprises and government agencies. These housing blocks are generally still managed by the plant or agency that employs the residents and little attention has been given to maintenance and repair, in part because rents paid by households are low (see Box on the previous page for an example). Responsibility for the maintenance of these housing blocks is being shifted to municipal or district housing administration agencies but the process is incomplete. In addition, many households have not paid rent for years.

It is also easier for governments to change their economic policies towards market-oriented systems than to change the legal and institutional basis for land-use management so these ensure poorer groups' land for housing needs are accommodated. Both Beijing and Hanoi have been affected by the economic reforms that moved from centrally planned economies to economies with much greater reliance on market forces - although state directed policies on housing and land use allocation remain important and it has been difficult to reshape these to fit within the new emphasis on the market economy. For instance, in Hanoi, the government has sought to improve land management and to support poorer groups to acquire housing but it is difficult to change housing provision from a centrally planned, state directed system to a market system and to adjust the state-controlled land allocation system to serve housing provision that poorer groups can afford. In Phnom Penh, the liberal market economy and economic success have brought a very rapid increase in the number of informal/illegal settlements for which the government's capacity to plan and manage land was ill-equipped to cope with.

Another consequence of inadequate land-use management that is evident in most of the case-study cities is the unplanned expansion of the urbanized area, driven by illegal land developments, relocations and illegal land occupations. This produces a patchwork of new developments on the urban periphery and a low-density sprawl to which it is expensive to provide infrastructure and services. This often results in unnecessary loss of agricultural land and also of land that should be protected because of its ecological or cultural value. This also means increasing numbers of urban poor households living far away from city centers and from jobs, either because they were relocated here or only here can they afford land. For instance, in Beijing, it is common for income earners within low-income households to be two hours travel from their source of employment. Without better land use management that delivers more options for lower-income households, the poorer groups will increasingly be pushed to those parts of the city periphery that middle and upper-income groups do not want for themselves. And as cities grow, what were formed and initially developed as peripheral poor settlements will become locations that are desirable to higher income groups or to commercial development and once again, their inhabitants will be pushed to wherever the city periphery has moved to.

Government structures and decentralization

Before discussing what governments do to address the kinds of housing problems and large backlogs in deficiencies in provision for infrastructure and services noted above, some consideration needs to be given to government structures and how these have changed, especially as a result of decentralization.

What 'government' does in any city is a mix of the policies, practices and investments of a range of different government bodies - usually including not only city and sub-city levels of government (district, ward or barangay) but also some that are national government agencies and/or provincial/state government agencies. Effective mechanisms to coordinate these are rare and the development of such mechanisms is usually inhibited by inter-agency competition, very different (political and economic) agendas and unclear jurisdictional boundaries.

Government agencies responsible for, for instance, the railways, airports or the courts or the Army, Navy or Air force may have unused land much needed for low-income housing, but they will not want to allocate this to housing for low-income groups. These same agencies may also strongly oppose any local government action to provide services to the illegal settlements that have already settled on their land or to develop plans to provide those living in these illegal settlements with tenure. So even a city government committed to regularizing tenure in informal settlements and to upgrading may not be permitted to do so in many informal settlements by other government agencies.

In addition, the greater the role of national, state and provincial government agencies, in general, the less accountability of government policies and actions to city residents. Even in cities with elected local and national governments, there is little possibility for citizen and civil society organizations in a city influencing the state and national government agencies working in that city. As later sections will describe, it is often government agencies at national or state/provincial level that promote large infrastructure or city redevelopment projects that devastate the homes, lives and livelihoods of large sections of the urban poor or that have unused land but oppose any measures to use this for housing for low-income groups.

Decentralization reforms have produced important changes in most of the case study cities - but in terms of addressing the needs of low-income groups, the two crucial questions are: Does decentralization give city governments more power and resources and thus capacity to act? And if city governments do get more capacity to act, does this actually bring benefits to urban poor groups?

In Karachi and Chiang Mai, there have been important local government reforms that are too recent to be able to ascertain the extent to which these change government policies towards urban poor groups. In Karachi, the 2001 Sindh Local City Government Ordinance has transferred power and resources from provincial to city government. Before the enactment of this ordinance, Karachi was divided into five districts, each with its own council. The Karachi Municipal Corporation was the parent institution to these, but its functions were limited to operation, maintenance and management of most infrastructure and services. Development planning and the implementation of physical and social facilities was carried out by agencies that were under the control of the provincial government. There are also a number of autonomous development authorities in Karachi that belong to various federal government institutions, such as the Karachi Port Trust, Airport, Railways, and the Armed Forces that exert a strong pressure on city affairs. Thus, much of what government did in Karachi was not under the control of the city government or accountable to city inhabitants. The 2001 ordinance made Karachi a district with its own mayor and deputy mayor and decentralized revenue generation to the district level although executive decision making for large projects still lie with the provincial government. Karachi is now divided into 18 towns and 178 union councils, each with its own mayor and deputy mayor.

BOX: ***The problem of central control over local planning in Chiang Mai . . .***

Chiang Mai is an important regional capital, but has long been ruled by officials appointed by the central government. Many of its government units are local offices of central government ministries with their staff appointed from outside (and with many regional government personnel rotating) and owing their accountability upwards to the central government rather than to local populations. There are also many government agencies with unclear and often overlapping responsibilities. Local government has no authority over housing issues (which are the responsibility of a central government ministry) or over the city plan (which is prepared by a department within the Ministry of Interior in Bangkok). Conservation (which is particularly important in Chiang Mai because of its rich historic and cultural heritage and its importance for tourism) and the construction of most major roads also comes under national ministries. However, important political changes during 2003-4 meant that a greater proportion of the government budget is now being allocated to local government units. Mayors are directly elected for the first time, and there is now a directly-elected provincial administration.

In Pune, the Commissioner who has most power is appointed by the state government, not elected, and there is a constant friction between the Commissioner and the elected city government. However, Pune is also a reminder that elected local governments do not necessarily produce a more pro-poor agenda. Decentralization (through the 74th amendment) has not made local government more responsive to low-income groups and may have increased the power of local real estate interests.

In Muntinlupa, decentralization reforms by the national government have been important for allowing the city government to develop a social housing program for the poor and to increase its own revenue base. But the city authorities and other groups involved in this program face difficulties in getting land to support this. National legislation and national agencies support local authorities in identifying and acquiring land for social housing - but most land is privately owned and expensive to acquire. As noted earlier, even where land is in public ownership, the government agencies that own it often want full market value for it - for instance for vacant land belonging to a local prison which is well suited for local housing development, the Department of Justice wants market value for it.

In Phnom Penh, most senior government personnel are still appointed by national government, including the governor and the vice governor, and the governor appoints the head of each district. The municipal government has more autonomy but little funding and it needs national government approval for its initiatives. In Cambodia, the decentralization program was designed primarily for rural areas, not for urban areas.

City government development policies

The combination of a globalizing world economy and the recognition by city and national governments of the need to be competitive within this has meant that most city governments give a high priority to trying to attract new investment. This usually results in infrastructure and city redevelopment projects that are meant to make the city more attractive to such investment. In any successful Asian city, there is also a constant need to improve and extend the infrastructure to support expanding economic activities and the expanding population's needs - for instance for water, sanitation, drainage, roads, electricity, transport and communications.

Through this process, the redevelopment or relocation of some 'urban poor'/illegal settlements is inevitable. The key issue in regard to housing and basic service provision is the extent to which urban poor organizations are permitted to influence what is done - both in seeking solutions that avoid relocation wherever possible (which is generally what urban poor groups prefer) and in developing relocation options in which those to be relocated can influence and that actually improve their conditions. This in turn depends in part on what influence urban poor groups can bring to bear on city government and in part in the attitudes of senior government staff to the urban poor - i.e. do they see them as 'the problem' or recognize that they are citizens with rights and also a critical part of the city's economy. In effect, the issue is whether the government bodies responsible for city infrastructure investments and city redevelopments see the needs and priorities of lower-income groups in the areas where they are to invest as central parts of their brief or as obstacles that have to be removed. At one extreme, there are government programs that work with those people and settlements who are affected by new developments to meet their needs and priorities - as in the resettlement of households living alongside the railway track in Mumbai[18] and in the policies of the Baan Mankong program in Thailand[19]; at the other extreme, there are government policies which simply bulldoze their settlements so large scale evictions are common. Evictions remain a threat for large sections of the population in all the case-study cities, although there are large differences in the extent of this threat and in how many people are at risk.

Government policies in Phnom Penh are particularly interesting in this regard, because of the change from one extreme to the other. In Phnom Penh, there is now an official recognition of the importance of supporting community-driven processes to address the housing problems faced by poorer groups; upgrading is now national policy rather than the previous policy of forced relocation, with those evicted relocated far from the city centre (and thus also from their sources of livelihood). As will be described in more detail later, the Solidarity for the Urban Poor Federation in Cambodia had a key role in promoting the change in policy, as it had helped poor communities within their districts come together, pool their own resources and develop their own solutions - and then seek partnerships with government in implementing these on a larger scale. This received support from Phnom Penh's government and then received support from the national government - as the Prime Minister announced the change in policy in 2004 and initiated an ambitious government program in Phnom Penh to upgrade "100 slums a year" over the next five years.[20]

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[18] Patel, Sheela, Celine d'Cruz and Sundar Burra (2002), "Beyond evictions in a global city; people-managed resettlement in Mumbai", Environment and Urbanization, Vol. 14, No. 1, pages 159-172.
[19] Boonyabancha, Somsook (2005), "Baan Mankong; going to scale with 'slum' and squatter upgrading in Thailand", Environment and Urbanization, Vol. 17, No. 1, pages 21-46.
[20] ACHR 2004, op. cit.; ACHR/Asian Coalition for Housing Rights (2001), "Building an urban poor people's movement in Phnom Penh, Cambodia", Environment and Urbanization, Vol 13 No 2, pages 61-72.

Government policies in Thailand have also changed to support upgrading of urban poor settlements wherever possible or other forms of community-driven redevelopment (for instance urban poor groups agreeing to redevelop their homes on part of the site they occupy in return for tenure or agreeing to move to another site close by). The precedents for these within government policy go back to the late 1970s - and received strong support during the 1990s through the national government agency, the Urban Community Development Office. In 2000, this organization was merged with the Rural Development Fund to form the Community Organizations Development Institute (CODI), which is now implementing Baan Mankong ('secure house'), an ambitious national program for upgrading and secure tenure. The program has set a target of improving housing, living and security of tenure for 300,000 households in 2,000 poor communities in 200 Thai cities within five years.[21] In Chiang Mai, urban poor communities that are part of this Baan Mankong program have shown how they can, if well organized, take care of the canals and historic city earth walls that are beside their settlements, as well as improving their homes and local infrastructure.

BOX: The Lyari Expressway: ***the clash between big infrastructure projects and people's housing . . .***

In Karachi, as noted earlier, there is a long-established official tolerance for the development of illegal settlements, and indeed government officials often benefit from these. However, large-scale infrastructure projects can still bring large-scale evictions. Most evictions take place in the name of 'development' - urban renewal, flyovers, mass transit and city beautification. But in reality, most of these are to make way for formal sector developers to build residential and commercial buildings. Many of these evictions violate state laws and procedures. Since 1992, some 16,470 houses have been bulldozed as a result of evictions and many more are under threat of eviction. There is also an increased incidence of fires in informal settlements sited on land that land developers want.

One example of an infrastructure project that brought large scale eviction threats was the plan to develop the Lyari Expressway. This threatened some 36,000 households as well as many businesses, and its construction would have brought serious negative impacts to Karachi's economy. To date, over 6,000 houses and commercial properties have been demolished. The compensation offered to those who were forced to move is a tenth of the value of the average house - plus a plot far away from the city centre where land is cheap. This expressway was planned and was to be built by a national agency, and this agency's refusal to accept local opposition was justified by the expressway being in 'the national interest.' Ironically, there is a cheaper, easier to implement road scheme that would actually be more effective at reducing congestion in the city (the main justification for the Lyari Expressway) and would need no evictions - but this would not be nearly as profitable for developers, contractors and many politicians and civil servants.

[21] Boonyabancha 2005, op. cit.

In Muntinlupa, several thousand urban poor households live along the railway tracks, and they know that they cannot develop permanent secure homes there. Many of these households are saving to allow them to acquire land and develop new homes elsewhere but the high cost of land inhibits this. The city government is supportive of pro-poor solutions but lacks the funding to support this. Without a stronger local government that exercises more initiative in directing urban development processes, the city authorities and the population will continue to be reduced to reacting to large land and infrastructure development undertaken by the private sector or central government agencies that are beyond their control and influence.

One final issue in regard to the link between city governments' development policies and the housing needs of poorer groups is what city governments do in regard to their cultural heritage. Many city governments in Asia have been so intent on modernizing their city that they have given little attention to protecting their rich historic and cultural heritage, and much new development has destroyed this. However, official attitudes are changing, in part because of a recognition that this heritage is important for city economies, as it supports revenues from tourism. But this too can produce anti-poor policies, as 'the poor' living in and around historic buildings and neighborhoods are seen as 'the problem'. This is an important issue in many Asian cities, as historic city centers contain large numbers of low-income groups who rent accommodation there, because of the advantages that such a central location provides for finding work. Chiang Mai provides an example of this, as many urban poor groups have settled in historic areas such as the city's ancient earth walls and the areas surrounding temples or pagodas.

City government attitudes to "the poor"

Although not much discussed in the city development literature, the attitude of city politicians and bureaucrats to 'the poor', their settlements and the ways they earn a living is clearly an important influence on government policies and practices. For instance, if government policies move to support the protection of a city's historic districts, is this done in ways that accommodate the needs of the low income population living there, or does it drive them out?

The influence of anti-poor official attitudes is most obvious where senior civil servants or politicians are explicit in stating that they think that the poor are a menace or poor settlements are 'eyesores' or centers of crime or environmental problems. These common attitudes form the justification for implementing redevelopment schemes that evict large numbers of low-income groups. But these attitudes also influence government practice right down the government hierarchy. For instance, how junior staff employed by water and sanitation utilities or solid waste collection services or schools and health centers or in police stations regard the poor influences whether the poor get services and the quality of these services. Discussions with urban poor households so often highlight their reluctance to use public services as, for instance, the staff at police stations, water companies or health care facilities, all of whom look down on them.

In most of the case study cities, there have been quite fundamental changes in official attitudes to informal or illegal settlements towards greater tolerance, as long as these settlements do not cause serious conflicts with powerful landowners. Those who occupy land illegally know this and generally avoid occupying sites that will create such conflict. This is usually accompanied by an official acceptance of 'upgrading' i.e. of some public investment in existing informal or illegal settlements to provide some basic infrastructure and services, although for squatter settlements, as noted above, this may be prevented by the land owners.

This change can be seen in Karachi, where upgrading and land regularization programs for squatter settlements date back to the early 1970s, when the People's Party made the rights of squatters an election issue and initiated a program to provide squatters with leases and urban services. (There were also precedents for this, going back to the many emergency settlements that developed on private and government land in the late 1940s as millions of Muslims fled from India, after Partition). However, the provision of leases was never on a scale to make much impact, because the process of getting leases was too long and cumbersome. Meanwhile, the land developed by government agencies for 'housing for the poor' was usually too expensive for low-income households and also difficult to obtain. However, over the last 10-15 years, the upgrading programs in Karachi underwent major shifts. A separate agency now runs this program in Karachi - the Sindh Katchi Abadi Authority (SKAA) - and it understands the dynamics of low-income settlements and works with community organizations in each settlement. Working closely with the Karachi based NGO, OPP-Research and Training Institute, they have adopted this NGO's well-established low cost sanitation methodology for its sanitation work, which means much lower unit costs, better quality work and more cost recovery. They have also made it much easier and quicker for squatter households to get leases - it now involves one step rather than 11 separate steps - and the result is that far more households apply for leases and the sale of leases generates revenues that are three times the cost of the investments.

But as noted earlier, 'what government does' in any city is a mix of what different government organizations and agencies do - so while the policies discussed above in Karachi certainly bring many benefits to large sections of the urban poor, there are still the eviction threats coming from the policies of other agencies. The different case study cities do show significant differences in how city governments view urban poor settlements and what provisions they make to accommodate the informal processes by which much of the low-income population get accommodation. In some cities such as Muntinlupa and Karachi, there is widespread government support for upgrading - and there have been important shifts in government policy in Phnom Penh away from eviction and towards upgrading. But these changes in attitude are not necessarily permanent. They are often eroded by the power of the nexus between large landowners, politicians and developers. Or they may change - as in, for instance, Mumbai, where there is a long history of partnerships between urban poor organizations (the National Slum Dwellers Federation and Mahila Milan) and local governments developing upgrading and new house developments together - yet suddenly, in December 2004, a new Chief Minister launched a massive eviction program.[22]

[22] Burra, Sundar (2005), "Towards a pro-poor slum upgrading framework in Mumbai, India", Environment and Urbanization, Vol. 17, No. 1, pages 67-88.

In all cities, there are politicians and government staff who see 'migrants' as one of the main 'problems' - although there are major differences in the extent to which this actually influences government policies. It is also very common to see politicians or government staff inaccurately equating 'the poor' or illegal settlements with 'migrants' when large sections of the low-income population (and the population living in informal settlements or inner city slums) are city-borne or have been in the city for years or decades. It is still common to see migrants blamed for environmental pollution, health problems and other 'social evils'. The irony is that city governments have adopted market-led policies, but refuse to accept market-led population movements. All the case study cities are seeking to encourage new investment, yet it is still common for city officials or politicians to view negatively the fact that people move in to the city in response to these same market-led policies. In Beijing and Hanoi, despite the shift within the national economies and national government policies to market-led development, the influence of central planning is still in evidence in household registration systems that act to deny many migrants access to better quality housing and services. In Beijing, only registered Beijing residents can work legally, rent accommodation and send their children to government schools. Anyone without this registration faces the risk of being deported. Much of the unregistered population live in illegal settlements far from the city centre and some run their own (illegal) schools because they are barred from government schools.

In addition, when successful cities attract migrants, many governments still see the problems of poor quality housing and backlogs in provision for new houses and infrastructure and services as 'too many people moving to cities' not as their failure to develop appropriate policies. Among the case study cities, this anti-migrant policy is most explicit in Beijing with the 3.8 million unregistered people there and the deporting from Beijing of unregistered workers. But this capacity to blame city problems on 'too many migrants' is common throughout the region.

Of course, many anti-poor attitudes are rooted in self-interest. For instance, in Pune, as noted earlier, the relocation of families living in 'slums' close to the inner city to peripheral locations was justified by an inaccurate claim that they were responsible for contaminating a canal. Most middle and upper class neighborhoods do not want urban poor settlements nearby, even though they do want the cheap labor and services provided by the inhabitants of these same settlements.

There are also the attitudes of politicians and civil servants to the poor that are not so much 'anti' poor but exploitative of them. For instance, most city politicians rely on patron-client relationships with particular 'poor communities' to get these communities' political support, and they seek to exclude communities that did not support them from benefiting from any government program. Many urban poor settlements depend on a particular politician or municipal official to avoid being evicted or to get services (or to ensure services remain). This can produce some spectacular examples of inappropriate policies, as with the politician in India who installed provision for water in the constituency where he sought election and then removed the water taps after being elected. In Karachi, there are many problems of local politicians supporting poor quality infrastructure improvements in their constituencies that are ill-coordinated with the plans and programs of the various agencies responsible for infrastructure.

Elected councilors generally do not want their patron-client relationships with urban poor threatened by the urban poor organizing and wanting a more transparent and official relationship with government agencies that does not have to go through their patron. As urban poor groups develop their own representative organizations, this often means also questioning the legitimacy of the 'community leaders' who manage the relationship with the patron. One local politician in Mumbai even admitted that politicians don't want the facilities provided to 'the poor' to last, because promises to renew or repair these facilities is useful for getting re-elected.

Finally, there is the issue of politicians promoting 'solutions' they have seen or read about from other cities that are completely inappropriate. For instance, the public housing program in Singapore has long exerted a powerful influence on Asian politicians, who do not notice the various unique factors that allowed Singapore to build and finance this housing. These include very slow population growth (the island city state had very little rural population to migrate to the city), among the world's most rapid economic growth (sustained over many years) and much of the land needed for this housing was already in public ownership (which greatly cut the costs of public housing and the ease with which it could be built). If Singapore had been located in any Asian nation with a large population, its economic growth would have attracted very large in-migration flows that would have swamped any government attempts to build such public housing.

The role of civil society, and especially organizations formed by the urban poor

The extent to which anti-poor attitudes prevail in government policies and investments is obviously affected by the extent of the influence of democratic processes. Within nations with elected governments, in general, national and state/provincial agencies operating in cities have less checks on their 'anti-poor' capacities than city governments. City governments supervised by elected councilors generally have more checks on their anti-poor capacities than those where senior administrators are appointed by higher levels of government.[23] Representative democracies within cities and nations are important for the checks they provide on anti-poor policies - but the evidence of the last 40 years in Asia show that of themselves, they are not enough to underpin sensible pro-poor policies. Pune in India is a successful, prosperous city with an elected city government in a nation that has had representative democracy for half a century yet the proportion of the population living in informal settlements and the number lacking adequate provision for basic infrastructure and services has grown rapidly. There is a recognition that urban poor groups need to be organized and to develop their own representative organizations to be able to take advantage of democratic systems - as

[23] Although with important exceptions; for instance, in India, some appointed city commissioners have proved more pro poor than elected city governments and have been important, both for moderating anti-poor pressures and in supporting urban poor groups' own initiatives and partnerships with local government agencies.

recognized by the urban poor organizations and networks or federations in India. Cambodia and Thailand.

The different case study cities illustrate the variety within Asian cities in regard to the way political systems and structures encourage or limit greater voice and influence for the urban poor. They also show the differences in how the urban poor themselves organize and interact with government. One of the most significant developments in Asian cities over the last two decades has been the development of representative organizations and federations of the urban poor that not only organize to demand change from government agencies but also undertake initiatives themselves and offer themselves to government agencies as partners. Where city governments respond appropriately, the scale of what can be achieved increases dramatically - and usually with unit costs that are far lower than conventional contractor-driven city development projects. These partnerships also have importance for two further reasons. The first is that they encourage and support urban poor groups becoming organized and engaging with city government agencies (and without this, no major long-term change in government policies and attitudes towards the poor is likely). The second is that they help change the anti-poor attitudes of politicians and government staff.

In several of the cities, including Pune, Phnom Penh, Chiang Mai, Karachi and Muntinlupa, there are good examples of innovative civil society initiatives (including those undertaken by urban poor organizations/federations) that have demonstrated more effective ways of improving conditions for urban poor groups.

BOX: ***Community toilets in Pune and Bombay***

In Pune, in 1999, the municipal commissioner invited NGOs and community organizations to bid for contracts for the construction and maintenance of community toilets in the city's low income settlements. This led to a very large-scale community toilet block construction program and with most such toilets being much better designed, maintained and managed than previously. The initiative had importance not only for Pune but also for demonstrating to government staff in other cities that this kind of partnership between local government and community organizations could deliver on a large scale. It encouraged government support for a comparable large-scale program in Mumbai, when local government staff saw how much better the community-designed, built and managed toilets worked than the contractor-built public toilets they had previously built. Many of these toilets in Pune and most of the toilets in Mumbai were constructed and managed by the National Slum Dwellers Federation and its member federations and Mahila Milan (savings cooperatives formed by women slum and pavement dwellers) with the support of the Indian NGO SPARC; these three organizations have built around 500 community-designed and managed toilet blocks that serve hundreds of thousands of households in Pune, Mumbai and other cities.[24]

[24] Burra, Sundar Sheela Patel and Tom Kerr (2003), "Community-designed, built and managed toilet blocks in Indian cities", Environment and Urbanization, Vol. 15, No. 2, pages 11-32.

In Phnom Penh (and also in other urban centers in Cambodia), organized urban poor groups have had an influence not only at project level but also on city government policies (and national policies) at the city-scale. The Solidarity for the Urban Poor Federation (SUPF) had a key role in this. SUPF was established in 1994 by women and men living in informal settlements in Phnom Penh and today it is active in half the city's informal settlements and in several other cities. The federation helped poor communities within their districts come together, pool their own resources and work out their own solutions to problems of land security, houses, toilets, basic services and access to credit for livelihood and housing. As in the urban poor federations in India and the urban poor networks in Thailand, the foundation for the organizations were community-based savings and credit schemes. They also used similar tools and methods to those used in India and Thailand to develop projects and proposals for submission to government - community-driven mapping and data gathering about urban poor settlements, house model exhibitions (where life-size models of housing are developed to test the most appropriate designs and explore their cost implications) and community-to-community exchange visits (to learn from each other). In Phnom Penh, Federation groups are implementing many pilot projects to serve as learning examples and to set precedents, and are also intimately involved in an ambitious program in Phnom Penh launched by the Prime Minister to upgrade 100 'slums' a year over the next five years.[25]

The different developments in Karachi described already show a complex mix of policies and practices, some of which bring major benefits to large sections of the lower income group population, some of which act to increase urban poverty. Karachi has a very active civil society, much of which has helped push for policies that better serve low-income groups. This developed as a result of constant struggles against undemocratic governments and inappropriate government policies and projects. Many civil society groups have developed new ways to address the problems in low-income areas. Perhaps the best known of these is the Orangi Pilot Project's widely adopted method of community-developed sanitation which is now not only implemented on a large scale in Orangi (an informal settlement in Karachi with 1.2 million inhabitants) but also in many other areas in Karachi and in many other urban centers in Pakistan.

Perhaps as significant as the hundreds of thousands of households that acquired good quality sanitation through this is the demonstration this model provides of 'component-sharing' for the provision of infrastructure and services. For low-cost sanitation, it shows how residents in low-income informal settlements are able to finance and manage the installation of good quality sewers and drains with no subsidy needed. But these sewers and drains need trunk sewers and drains into which to integrate. If government agencies concentrated on providing this trunk infrastructure, leaving communities to install the sewers and drains within their neighborhood, there are very large cost savings to government and much lower unit-costs overall. This 'component-sharing' model can also be applied to water supplies (government providing the water mains with good quality, regular water supplies, resident groups installing the piped systems within their neighborhood) and to other government services. The

[25] ACHR 2001, 2004, op. cit.

importance of such 'component-sharing' is that it shows the possibility of greatly increasing the proportion of city households with good quality, legal provision for infrastructure and services.

Karachi has another innovation that has great relevance for Asian cities - its own independent research and communications institution and supporting network. In recent years, different groups within Karachi's civil society have started to work together to press for change and reform - including professionals, academic institutions, NGOs, CBOs and other grassroots community organizations. This has been supported by NGOs such as the Urban Resource Centre as it provides space for interaction, networking and lobbying on key urban issues and keeps civil society groups informed of government policies and plans. This Resource Centre also arranges discussions and negotiations between civil society groups and political parties and different tiers of government (see Box on next page). Operating through these kinds of negotiations and also through court cases and demonstrations, civil society groups not only oppose inappropriate plans and projects but also propose alternative plans and develop lobbies to support them. Their influence in government plans and policies is evident in, for instance, the government's katchi abadi improvement program, the redesigning of the city-wide sewer and drainage system and changes to a mass transit program. Civil society representatives are now included in various government bodies and the setting up of Citizen Community Boards in the 2001 Local Government Ordinance shows the means by which civil society can be formally included in local governance. However, the difficulties of actually getting change is illustrated by the fact that to date, very few such boards have been created and those that have created have yet to become effective.

BOX: Rethinking the role of research and information: *The Urban Resource Centre in Karachi*

The Urban Resource Centre was set up in Karachi in 1989 by urban planning professionals and teachers, NGOs and community organizations to serve as a centre of research, information and discussion for all civil society groups within the city. It reviews all proposed major urban development projects from the point of view of communities and interest groups and makes these reviews widely available - for instance through quarterly reports, monographs and a monthly publication Facts and Figures. It organizes forums that allow different interest groups to discuss key issues relevant to Karachi - and by doing so, has been able to develop much more interaction between poor communities, NGOs, private (formal and informal) sector interest groups, academic institutions and government agencies. For instance, research and forums have examined in detail the problems faced by flat owners, scavengers, theatre groups, commuters, residents of historic districts, working women, wholesale markets and transport companies. It also arranges discussions and negotiations between civil society groups and political parties and different tiers of government.

This URC and the network of NGOs of which it is part helped to get the Lyari Expressway stopped twice, as it was uprooting 150,000 people and causing immense environmental damage to the city, and replaced with the Northern Bypass. Its proposal for the extension of the Karachi circular railway into Orangi and other areas of Karachi has been accepted. It has also supported many other initiatives that changed government policies or the way government agencies work.

The URC has five staff members and provides one year fellowships to young university graduates and community activists who help it undertake research, documentation and interaction with communities and interest groups. The annual budget of this important resource centre is the equivalent of only around US$26,500.

In Hanoi, community-level organizations have importance, but mainly through local branches of mass organizations, such as the Women's Union and the Veteran's Union. These provide services to their members (for instance micro-credit) and help organize community action to, for instance, improve infrastructure. With the shift away from a centrally planned economy, these have become less top down although they are not independent of government since key staff in these organizations get government salaries and local groups and associations are in a hierarchical relationship with district, city, provincial and national levels of their organizations.[26]

In most examples of participation, the 'participation' of urban poor groups is restricted to specific initiatives and not to broader governance structures. For instance, in Pune, the city government's support for public toilets allowed far more community influence on their design

[26] See the case study listed on page 1; see also Parenteau, René and Nguyen Quoc Thong (2005), "The role of civil society in urban environmental rehabilitation: a case study (Thanh Xuan district, Hanoi, Vietnam", Environment and Urbanization, Vol. 17, No. 1, pages 237-248.

and management and far more toilets to be built, and this brought important benefits to large sections of the 'slum' population - but this did not mean more influence for this same population in other areas. Indeed, increasingly successful urban poor organizations in Pune faced strong opposition as they challenged established relationships between elected councilors and slum residents and between the bureaucracy, building contractors and councilors. Even where urban poor organizations do get more influence at city scale, maintaining this influence will always be a struggle; even city authorities committed to pro-poor development are frightened of allowing urban poor organizations influence beyond the project level.

The influence of the bigger picture on this and the role of international agencies

Powerful international agencies have been promoting the downsizing of governments and the 'globalizing'/neo-liberal agenda, and most governments in Asia have bought into this. Indeed, most of the examples used of nations that have been most successful in market-driven development are in Asia. It is also difficult to see how any government can meet its responsibilities to its lower-income population without a successful economy. However, many Asian governments support market-driven policies without addressing the contradictions that this produces in cities between what drives their economic growth and what contributes to adequate accommodation for their populations. This is not a problem concentrated in the poorer or least economically successful cities within nations but also in cities with increasingly prosperous economies such as Pune in India and Phnom Penh in Cambodia.

The conventional wisdom is that governments which create the conditions for economic success in a city or nation will then have a stronger economic base from which to compensate those who lose out by this, including those who lost their jobs from government downsizing. For instance, in Karachi, privatization of government assets and utilities led to the loss of 120,000 jobs. Very large cuts in public sector primary schools and health care have worsened service provision for much of the low-income population, who cannot afford to use private services. In addition, prices for water, electricity, telephone, gas, sewerage and transport have all increased significantly - which has led to the closure of many small-scale informal industries. These reforms are justified by their potential to produce economic growth which then generates the resources that allow better provision of infrastructure and services. But Pakistan has only limited possibilities of maintaining any comparative advantage within Asian or global markets. For example, its light engineering industry, which employed 600,000 persons, is closing down as it cannot compete with Chinese products. The two important issues here are first, what happens in cities where the market reforms do not produce the basis for prosperity? And second, where they do provide the basis for prosperity? What needs to be done to ensure that poorer groups benefit?

International agencies, including both the bilateral aid programs of high-income nations and the multilateral development banks, should have important roles in addressing both these issues. Their entire operation is justified in regard to the benefits that they will produce for 'the poor'. In many Asian nations, these aid agencies and development banks have considerable influence on government policies and priorities. What mechanisms (if any) have these international agencies used to ensure benefits for poorer groups? These international agencies certainly give little scope to allow the poor, who are meant to be their clients, any say or influence on what they prioritize and how they implement this. If the national governments to which they provide development assistance give little priority to addressing poorer groups' needs, then these international agencies also generally give poorer groups' needs little priority. For instance, Cambodia received some US$ 2.6 billion dollars in development assistance 1996-2001, yet despite this and rapid growth in the economy, there is little evidence that the poor benefited much, even in Phnom Penh, where much of the economic growth was concentrated. And how much of this $2.6 billion investment was influenced at all by any dialogue with the poor in Cambodia?

There are also many donors working in Asia that support rural poverty reduction, while ignoring the poverty and rising inequality in urban areas. In effect, they are still stuck in 1970s conceptions of development, when the problem of 'urban bias' in development first came to be discussed. Since 1970, Asia's urban population has increased by 321 percent while its rural population increased by 42 percent. United Nations projections suggest that virtually all the increase in Asia's population between 2005 and 2020 (some 650 million people) will be in urban areas. A large and growing proportion of those with unmet needs in Asia live in urban areas. Yet many international agencies working in Asia have no urban program. In addition, for those agencies that do, rarely do these urban programs give much attention to the needs and priorities of the urban poor - as they concentrate on the infrastructure to support economic growth.

Most international agencies working in Asia need to reconsider their policies (or lack of them) towards urban areas and urban poor populations. However, a growing role for international agencies supporting pro-poor policies in urban areas has to avoid the current tendency to support over-expensive solutions. Large official donors, by their structure and mode of operation, usually encourage unnecessarily expensive projects. This is especially the case with development banks, which rely on large loans to help cover their own management costs - although this tendency to prefer large, expensive projects is also evident in grant or soft-loan providing bilateral agencies, as they are pressed by the governments that fund them to keep down their staff costs. The national government agencies with whom international agencies work, the government staff responsible for managing the projects and the contractors who get the work, also benefit from expensive projects. A shift to supporting locally-driven development that is accountable to urban poor groups and that draws on their resources and capacities can bring very large reductions in costs and large increases in the proportion of these costs that can be funded by local sources.

There is also the issue of linking the social funds and other mechanisms used by many international agencies to support 'poverty reduction' with local organizations. Ironically, many of these social funds are meant to improve provision for the services that were formerly provided by government, but were then cut or stopped by government downsizing. Good quality basic services need competent, accountable local governments to ensure they are provided, even if particular services are contracted to private or voluntary organizations.

[Note that this section focuses on the role of the official bilateral aid agencies and development banks; no consideration has been given to the important and influential role of certain key international NGOs in this area, e.g. SELAVIP, Misereor, the Ford Foundation and Homeless International.]

Conclusions

Drawing on precedents that have already been implemented in different Asian cities, it is possible to envisage city-government policies that are far more effective at improving housing and living conditions and at contributing to reducing poverty without requiring levels of external funding that are unrealistic. Indeed, in many cities, little or no international funding will be required. At the core of these precedents are changes in the way that city governments engage with urban poor households and communities (and the informal processes by which most of these groups get housing) and in the ways they support these households' and communities' capacity to act, to invest and to contribute to managing development.

The need for such changes is urgent, as much of Asia continues to urbanize rapidly and as most urban governments are failing to address the needs of large sections of their population. There is something wrong with city plans and city government land use management programs if they exclude large sections of that city's population from legal housing markets and authorized land developments for housing and access to infrastructure and services. Yet in most cities in Asia, this is what is happening. This exclusion of large sections of the population is even happening in cities that have had rapid economic growth. Indeed, expanding city economies act to increase this exclusion, if governments do not act appropriately. It also happens in cities where much of the land is under public ownership, which highlights how the difficulties that poor households face in getting land for housing is as much a political issue as it is an economic one.

There is also something wrong with any government housing policy that fails to recognize the incremental processes by which much of the urban poor get housing and by which much of the urban housing stock in the city gets created. Without these informal processes, housing conditions would be much worse. In Karachi, these informal processes account for about 60 percent of all new housing (including virtually all the housing that poorer groups can afford) and have actually contributed much to a significant decrease in the proportion of Karachi's households living in one-room dwellings, a decrease in the average number of persons per room and large increases in the proportion of households with water supply and sewers. In most informal settlements in Asia, there is both a desire among their inhabitants for improvement and a capacity to invest and to manage upgrading programs that, if supported with credit and technical expertise, can transform housing and living conditions on a city-wide scale. But this will need changes in the relationships between government agencies and community organizations. This will also need changes in planning methods and in the generation of basic data which is used to plan and set technical standards.

Among the eight cities on which this paper has focused, there is evidence of important changes in these directions but not on the scale needed to cope with growing demand, let alone to reduce the backlog. For instance, in Muntinlupa, there is a city government that recognizes the importance of the informal processes by which most housing that low-income groups can afford gets constructed and has various initiatives underway to support this - including a bridge financing facility to help poor communities acquire land - but the city authorities lack the resources to do so on the scale that is required.

In Karachi, the changes brought to the upgrading and regularization of squatter settlements by the Sindh Katchi Abadi Authority were described earlier. This is also an example of how government programs can become more effective, larger in scale and more independent financially, through cost recovery. In Phnom Penh, there has been a remarkable change in policy from anti-poor evictions to pro-poor upgrading. In Thailand, the Baan Mankong upgrading program shows how a national program can support the kind of city-wide development processes in which urban poor groups are fully involved.

These are among the many precedents that show how governments can work with urban poor communities. The challenge is to get comparable community-driven developments in many more cities and to greatly increase the scale of their impact in each city. The key underlying issue in all this is how do the needs and priorities of lower-income groups get represented within what governments do (or do not do) beyond specific projects. Obviously, this is influenced by the political system. Undemocratic local and national political systems rarely give any priority to addressing the needs of lower-income groups in cities. Even in many Asian cities where there are representative democracies at national and local levels, the poor get little attention. In many instances, this is partly because elected city governments lack the power and resources to act. Decentralization is an important part of more effective solutions - and as this paper has noted, decentralization programs have often given city and municipal governments more responsibility for such things as land use planning, urban development and housing, but too often, these lack the staff and the funding base. City governments need resources and often need national agencies to support this.

But there is also no automatic guarantee that elected politicians will address the needs of poorer groups. For instance, in Pune, politicians may sound pro-poor in what they say, but the political parties push through decisions that serve their own ends and support real estate developers. In India, in general, it is so common for what appears to be pro-poor policy change at national level to be hijacked by powerful vested interests.[27]

Many civil servants and local politicians still do not see the poor as a key, and as a legitimate part of their cities. It is almost as if they do not think that the poor have a right to live in the city or to move to their city. These 'anti-poor' attitudes are also evident in the way that urban poor communities are so often forced to move, to make way for projects in the public good: to allow infrastructure to be developed, to support city regeneration or to improve health and safety. But most of those who are relocated (usually against their will) want improved health and

[27] For instance, see the discussion in the Pune case study of the implementation of the Land Ceiling and Regulation Act, national legislation that appeared to be very pro-poor but that failed to be so. Progressive national legislation is not much use if city governments are resolutely opposed to using it, or can use it in ways to further their interests.

safety, better infrastructure and a more successful economy as well. Many would be happy to move, since they live on land at risk of floods or landslides or on pavements - as long as they can help determine where, when and how. In most instances, the problem is not the cost of resettlement (which is generally very low compared to the cost of the infrastructure) but the anti-poor attitudes of city authorities.

Even in cities where more progressive views of the urban poor prevail, the possibilities for the urban poor to engage at city level is usually very limited. The poor's participation is still seen as happening only at project level. The influence of the urban poor and their organizations in Phnom Penh is one example of where this engagement has gone beyond project level. In Muntinlupa, there are also changes that allow more representation of urban poor groups in city-wide discussions, but these have not yet proved to be effective. In most instances, city governments are not ready to see urban poor communities as partners at a city-wide scale.

One of the most difficult issues for any city government is how to get land for housing markets to work better for those with limited incomes - both in addressing the backlog (the number of people living in illegal settlements lacking provision for basic infrastructure and services) and in ensuring there are alternatives to illegal settlements for new households. While in most of the case study cities, local governments have become more tolerant of the informal ways by which poorer groups get land for housing, they still play a largely reactive role. There is a need to find ways to help low-income households who want to develop their own homes to get land with services, in locations not too distant from their income-earning opportunities. Again, in several of the cities, there are precedents for this - but not on sufficient scale.

In some cities, an innovative methodology has been developed to help do this. In Phnom Penh, for instance, the city-wide survey that urban poor organizations helped to implement both identified the scale and location of all urban poor communities and also identified vacant land that might be used for low-income housing (a methodology that has also been used in many other Asian cities).[28] In Karachi, the careful, detailed mapping of all informal settlements showing the location and quality of their infrastructure serves both to highlight the scale of community investments in infrastructure and to provide the basis for infrastructure improvements (including linking community-designed and implemented sewers and drains to city-provided trunks).[29]

The 'solutions' to very poor quality housing and lack of infrastructure and services that most low-income groups suffer in Asian cities will have to be developed within each city. These are not problems that external funding from national governments or international agencies alone

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[28] Boonyabancha 2005, op. cit.; Asian Coalition for Housing Rights (2000), Face to Face: Notes from the Network on Community Exchange, ACHR, Bangkok, 32 pages; Patel, Sheela (2004), "Tools And Methods For Empowerment Developed By Slum And Pavement Dwellers' Federations In India", PLA Notes 50, IIED, London.

[29] Rahman, Perween (2004), Katchi Abadis of Karachi; a Survey of 334 Katchi Abadis, Orangi Pilot Project Research and Training Institute (OPPRTI), Karachi, 24 pages; Hasan, Arif (2005), The Orangi Pilot Project-Research and Training Institute's Mapping Process and its Repercussions, a paper prepared for UN Habitat.

can address. External support can help a lot, but only if it supports urban poor groups to get more influence, more possibilities of better provision for housing, infrastructure and services, and better protection against anti-poor attitudes and policies. External support can also help if it supports local governments' capacities to develop locally appropriate, cost-effective interventions which minimize the need for external funding. There are also precedents to draw on that show how this can be done.

What is needed to make Asian cities work better for their low income populations:

1. Ensuring more influence for low-income groups and their organizations on what government does and how it spends its budget at a city scale, not just on individual projects. This acquires greater importance in a globalizing world, as more and more city governments actively compete for new investment and invest in 'big infrastructure' and other facilities designed to attract new investment, in ways that can be very anti-poor.

2. Local government commitment and capacity to sort out land tenure for those living in illegal and informal settlements in ways that are pro-poor (which can include resettlement where needed but this has to be done in partnership with those to be resettled).

3. Local government commitment and capacity to ensure that low-income households which want their own home can find suitable land sites with infrastructure and services at prices they can afford. (This is perhaps the most difficult for local authorities to implement.)

4. More commitment among all public and private service-providers that have responsibility for providing water, sanitation, drainage, health care, schools, electricity, law and order, etc. to extend and improve provision for low-income groups and in low-income settlements, as well as more flexibility in developing locally-appropriate models and more scope for urban poor organizations to influence what they do, including, where appropriate, working in partnership with them.

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MARKET-BASED MODELS FOR LAND DEVELOPMENT

FOR THE LOW/MODERATE-INCOME MAJORITY

Bruce Ferguson

Hybrid value chains (see Ashoka, 2008 and Ferguson, 2008 in this issue of *Global Urban Development Magazine*) provide a tool to analyze, improve, and create affordable housing projects and products. Nowhere is the need and opportunity greater than in land development (*Global Urban Development Magazine*, November 2007).

Virtually all net growth of 2.6 billion in world population between now and 2050 is projected to occur in emerging-country cities. The majority of these new households will earn low or moderate incomes. In effect, relatively poor countries must build the equivalent of a city of more than one million people each week for the next 45 years (Cohen, 2005)! Rapid rural-to-urban migration (particularly in South Asia and Africa, where large majorities still live in rural areas) as well as in-situ population growth have created this surge in urban population. Although these households will earn incomes well below those of affluent countries, the huge increase in emerging-city populations will drive growth in the world economy and demand for many products. From 2001 to 2007, emerging economies grew at an average annual rate of over 6% compared to 2.5% in high-income advanced countries, and have resisted the current "credit crunch" (as of July 2008) far better than affluent nations. The importance of emerging nations in the global economy will only increase in coming decades

Absent major change, the bulk of new residential land development will occur informally without integration into mainstream markets, at tremendous public and private cost. Settling this wave of new urban residents far exceeds the challenge of upgrading existing urban shantytowns containing one billion people. Experts (*Global Urban Development Magazine*, 2007; Freire, Lima, Cira, Ferguson, Kessides, Mota and Motta, 2007; Ferguson, 2007; Buckley, 2005) and housing developers agree that land presents the greatest constraint to sheltering the low and moderate-income majority. Government programs, however, typically result in boutique high-subsidy projects incapable of reaching a scale commensurate to this challenge. New market-based approaches are essential to reach the enormous necessary scope.

This paper first presents a hybrid value-chain framework with particular attention to urban land development to provide a systematic method for guiding private-sector initiative. It then uses this framework to analyze and specify how to improve two cases of market-based urban land development – one in Pakistan with a nonprofit as the developer and one in El Salvador where for-profit firms are the protagonists – based on interviews and reports prepared for this study. This analysis also helps identify the roles of private firms, the citizen sector (variously called "nonprofits", "NGOs", and the "social sector"), and government in achieving massive low-income land development.

A hybrid value chain approach to urban land development

Table 1 (distilled from Table 2 of Ferguson's policy introduction on the value chain framework to this issue of *Global Urban Development Magazine*) lists the main steps of the progressive housing process used by most families in emerging countries, a set of overall criteria to assess outcomes, and products and services for streamlining this practice. The key to creating value and markets in affordable housing is not only to lower the costs of each of these steps but also, more importantly, to innovate and combine products and services into new business models that address larger segments of the problem – i.e. "value chains."

Modern companies develop competitive advantage by vertically integrating the sourcing, manufacturing, and delivery of packages of products and services (Porter, 1985). Hence, these firms are well suited to squeezing costs out of the progressive housing process. However, they typically have little direct access to poor communities, which they find dangerous and difficult places in which to work, and to low-income people, who usually do not trust them. Citizen-sector organizations that work in these neighborhoods can perform an important function at critical junctures in the value chain. As a result, the most effective value chains are "hybrid" efforts that join modern corporations with citizen-sector organizations.

A broad summary of the context of residential land development in emerging countries cities serves to preface application of this hybrid value-chain framework to specific projects and products.

During the early phases of the great urban wave during the 1950s and 1960s, poor households migrating to cities from the countryside could, with some frequency, find centrally located low-cost parcels to invade. This land offered a low-cost foothold near to the city center and jobs, which families could turn into a valuable asset.

However, continuing urbanization has used up most land vulnerable to invasion. As a result, most new low/moderate income households now settle in illegal subdivisions on the periphery and beyond, stretching over vast areas. In effect, illegal subdivisions have become the default mechanism for urban land development. Typically, clandestine developers acquire parcels, mark areas for dirt streets, divide the remaining area into lots, and sell these raw lots to poor households. Most emerging countries and cities have officially made such unserviced land development illegal under their subdivision codes. However, the bulk of these governments unofficially allow or promote unserviced land development as the only viable alternative for massive low-income settlement. Others lack the enforcement mechanisms to control this phenomenon.

Table 1: Framework for assessing and improving affordable housing projects and products

Steps in the progressive housing process	***Goods and services necessary to streamline proces and reduce costs***
1. Acquisition and occupancy of a lot *a. Physically occupy lot* *b. Pay for lot* *c. Starter infrastructure for occupation* *d. Construct an initial makeshift shelter*	• Formally-developed subdivisions with "starter" services (e.g. collective water and a gravel road network) located near trunk infrastructure lines • Low-cost norms and streamlined processing for approval of subdivisions with "starter services" (e.g. communal standpipes/wells or "tanker" water, dirt roads, electricity) and progressive provision of other infrastructure and services over a predictable timeframe
2. Upgrading property tenure for security of occupation *a. Maintain physical control of the lot* *b. Achieve secure tenure* *c. Full legal title*	· Legal, financial, and administrative assistance in upgrading security of tenure. Land developers, building materials retailers and manufacturers, and utility companies have an interest in increasing the security of tenure of the low-income communities that they serve.
3. Provision of basic infrastructure *a. Upgrading (e.g. road network, paving, drainage)* *b. Adequate sanitation (improved pit latrines or sewerage)*	• Lobbying for and brokering infrastructure and collective services from various levels of government and private sector organizations. • Organizing the community to help maintain and pay for installed infrastructure and collective services (e.g. cleaning drains, operating community centers)
4. Construction of the house structure *a. Improve/ expand unit of owner occupant* *b. Add accessory units and spaces for relatives and rental income*	• Packages of high quality building materials. • Technical assistance in design, budgeting, and construction of houses • Market information on the type of home improvement and upgrading of property tenure that increases home values.
5. Finance of steps in progressive housing process *a. Household savings vehicles* *b. Small serial short-term credit for:* *-purchase of lot* *-infrastructure provision and connection* *-expansion and improvement of structure*	• Organizing groups of households to save for home upgrading and to demonstrate creditworthiness. • Saving vehicles that create discipline and give a positive real interest rate • A range of credit including: microfinance; supplier and consumer credit from developers and building materials retailers; and small mortgage loans; not only for building materials but also for specialized technical labor.

Steps in the progressive housing process	*Goods and services necessary to streamline proces and reduce costs*
6. Building community institutions to combat insecurity *a. Formation of neighborhood groups* *b. Local and international NGOs support neighborhood groups* *c. Neighborhood groups and NGOs partn with public and private sector to increase security*	• Organizing community associations and funding sources to operate them. • Developing women's networks to market goods and services • Community centers with daycare and youth facilities • Agreements with the police and other authorities that enhance security • Investment in street lighting and local police stations
Overall characteristics	***Outcome measurement/description***
1. Sustainability *a. Scale* *b. Financial* *c. Political* *d. Environmental*	• Number of units produced relative to demand (ne household formation) • Positive net return • Reliance on government action and resources, ar dependability of this public support • Impact on households' health and the natural environment
2. Location relative to existing infrastructure, services, and jobs	• Distance from trunk infrastructure, services, and jobs
3. Targeting/affordability	• Share of project/product that serves low-income households

Illegal subdivisions present an enormous dilemma. They are typically the only affordable means of low-income settlement, have simple procedures, and deliver their product rapidly. However, illegal subdivisions lock in many of the extremely high costs of progressive housing over time (Ferguson, 2008). Households pay clandestine developers many multiples (often, 10x to 20x) their cost for individual lots without receiving full legal title. They then struggle to keep physical possession and upgrade their rights to their lot (step 2) by keeping an adult family member (typically the wife) on site around-the-clock instead of working outside the home, bribing local police and officials, and paying the costs of regularization and registration of property ownership. In order to occupy the lot and begin consolidating their home and community, families build a makeshift shelter and acquire water and electricity via clandestine connections or by paying private suppliers many times the cost of publicly-supplied services for poor quality.

Upgrading this infrastructure (step 3) and building a permanent home (step 4) destroys these households' initial investment by retrofitting a new road/services layout to the community, typically at two to three times the cost of formal-sector development, and by replacing the makeshift shelter. Households pay exorbitant rates both to save and to borrow to finance this process (step 5). During the consolidation phase (steps 3 to 6), families and neighborhoods usually suffer from much higher rates of crime, violence, and insecurity of all types than formal settlements of a similar socioeconomic profile; they combat insecurity by building community institutions (e.g. neighborhood associations and groups of all sorts), establishing alliances with supportive NGOs, and developing partnerships with public agencies (step six), particularly the police.

In this context, creating value chains for land development involves making clandestine subdivisions legal through regulating and supporting their development in order to reduce the cost and length of this process. The following sections summarize two in-depth case studies of market-based low-income urban land development, and then apply this hybrid value-chain framework to rate and specify how to improve them. The full versions of these case studies are available on Ashoka's website at www.ashoka.org.

The progressive subdivision market in El Salvador

Progressive subdivisions started in the 1960s in the municipalities of the capitol, San Salvador (Barraza, 2007; Souza, 2001), and now serve 60% of new low-income households throughout the country, with sales of 5,000 to 8,000 lots per year.

Roughly 70 firms belong to the Association of Land Developers of El Salvador, and are active in this market. The four largest firms (Argoz, Proyectos Dinamicos, Lotiversa, and Ivan) operate on a national scale and account for one-half of new lot production (Barraza, 2007; Souza, 2001).

Typically (80% of projects), firms approach landowners of parcels near or on major roads on the urban periphery and in semi-rural zones, and offer to form partnerships to subdivide this land. The firm commits to execute and administer the subdivision, and pass on 60% to 75% of payments from individual households to the landowner.

The developer sets aside 35% of the parcel for streets, communal infrastructure, and, higher-end projects, green space, and then divides up the remaining 65% into 20 to 35 lots of 150 square meters (in suburban zones) to 250 square meters (in semirural zones). The firm levels and prepares the terrain, demarcates lots and roads, compacts dirt roads, and, for higher-end projects, drills communal wells and leaves space for parks. Electricity companies make individual households connections in parallel with the subdivision.

Marketing usually consists of putting a billboard at the front of the parcel advertising lots for sale with a telephone number. Developers establish local offices to receive monthly payments and also make arrangements with banks to receive these monies on their behalf. Low-income people buy the great bulk of these lots. In addition, significant sales now come from the Salvadoran community in the US seeking to build a home to retire to their native country and investors.

Developers use a rental contract with promise of sale (*contrato de arrendamiento con promesa de venta;* hereafter, called a "rent-to-own contract") for this purpose. This rent- to-own contract stipulates a monthly payment of US $15 to $70 per month for 8 to 12 years, representing an affordable 15%-20% of income of low and moderate-income households earning US$175-$350 per month. This legal vehicle maintains ownership of the lot with the developer/landowner partnership until the last monthly payment, which reduces the risk and capital invested.

Developers typically phase their subdivision over time, so that both the developer/landowner partnership and families that purchase early gain from the appreciation resulting from the occupation of the project. Developers invest a small amount – US$300-$700 per lot – in starter infrastructure that approximates the norms set by government regulation. Firms ignore regulations that would raise costs to levels that would price their product out of their target market segment.

Families then build the structure of their homes and pressure government for other services – most importantly, piped water – which generally arrives 10 to 15 years after the initial development – and paving of roads and schools, which usually takes longer. Virtually none of these settlements have piped sewerage – the most costly type of infrastructure. Instead, residents build unimproved pit latrines, which frequently contaminate underground water and wells – the main source of their drinking water.

This *modus operandi* results in monthly payments affordable to a wide range of low and moderate-income households. However, rent-to-own contracts can be highly problematic. Arrears of three or more months in payment permit the developer to repossess the lot and sell it to another family. On making the final payment, some families discover that the developer/landowner partnership has mortgaged or sold the land to others, and have problems getting clear legal title to their lot.

From the perspective of developers, the low investment of capital in projects has allowed massive production of progressive subdivisions that has substantially exceeded demand but, nevertheless, turned a profit. The three largest developers have produced an average of 10,500 lots per year compared with annual sales of around 3,000 lots per annum. Financial analysis of a typical project in one of the most active current markets (municipality of San Miguel) shows a net return of 25% to 35% per annum, around the national median profit rate for private-sector investment.

Progressive subdivisions started in the 1960s, but occurred outside of national and local law until 1992. In 1992, national government approved the Law for Urban Development and Construction and Regulation of Subdivisions (Barraza, 2007; Souza, 2001). This law created a category called "Subdivision for Progressive Development" for low-income households, a Social Register of Real Property, and the Institute Of Liberty and Progress (model on and on Hernando De Soto's efforts in Peru of the same name) in order to legalize informal settlements. In addition, national government has established a Management Unit within the National Real Property Registry Office to approve these plans while municipal governments – which are constitutionally in charge of land-use – also review progressive subdivision applications if they have land-use plans. These and other agencies including the Ministry of the Environment participate in an inter-institutional committee to review progressive subdivision applications, which constitutes a “one-stop shop” (“*ventanilla unica”*) that coordinates the approval process for developers.

The progressive subdivision industry and its regulatory framework in El Salvador have produced marked positive and negative results:

The regulatory framework adopted in 1992 has succeeded in converting an illegal industry into a legal one that has rapidly expanded and now serves 60% of new low-income households. Government review has helped keep development away from the most environmentally-hazardous locations. In contrast to the 1960s when illegal subdivisions occurred on hilly lands and floodplains, regulation has influenced developers to locate new projects on flat land with suitable soils, although at increasing distances from city centers.

On the other hand, unoccupied progressive subdivisions now consume large areas in semirural regions as well as the urban periphery throughout the country, displacing other land-uses such as agriculture. Transfer of legal title to households on payment of the last installment of the rent-to-own contract continues to be a major issue; a substantial backlog of progressive subdivisions (mainly from before passage of the national legislation in 1992) remain illegal. The government review process still creates some dilemmas for developers; in particular, the minimum lot size of 100 square meters for urban areas is large compared with other Latin American countries.

While some regulatory issues remain, the low amount of funding for new water and sanitation infrastructure is now clearly the major bottleneck to low and moderate-income settlement. The water and sanitation system of El Salvador suffers from weak governance and under-capitalization. Municipal governments receive a very low share of national tax revenues in intergovernmental transfers (8%) compared to the Latin American average (15%), and lack funds for local capital investment. The lack of funding for infrastructure contributes to causing the central problem of progressive subdivisions: although the progressive subdivision system effectively settles a large share of the low/moderate-income population of the country, it provides virtually no support for consolidating the resulting communities over time.

The Low-Income Land Development Projects of Saiban in Pakistan

Public landownership in Pakistani cities is high, ranging from 20% to 40% of urban property. The lack of housing finance, urban development funding, and property tax systems discourages private real property owners from development and encourages them to hold raw land for speculation at prices unaffordable to the majority (World Bank, 2006). These factors throttle legal land markets and create a perverse dilemma for low-income housing. Pakistani cities and Karachi (Dowall, 1991), in particular, have ample vacant land including many unoccupied formal subdivisions. However, most low and moderate-income households cannot afford the prices landowners ask for these lots.

Lacking any legal alternatives, most Pakistani families either participate in unorganized land invasions or buy lots in illegal subdivisions, which account for the bulk of urban settlement since the 1960s as parcels suited to land invasions have become scarce.

The public sector has an official and an unofficial response to these severe bottlenecks in housing and land markets, and the lack of affordable housing. Officially, government agencies have experimented with a wide range of housing programs including sites and services, low-cost core units, and slum upgrading. However, government-produced housing covers a negligible part of need and demand.

Unofficially, public officers enter into arrangements with private-sector builders to develop publicly-owned land informally – i.e. the default mechanism of informal subdivision that predominates in most emerging-country cities. Clandestine developers collude with government authorities to use public land on the urban periphery without formal legal transfer.

The former head of the urban development authority in Hyderabad, Tasneem Siddiqui, started Saiban, a citizen-sector organization**,** in 1987 in order to improve upon and formalize informal low-income settlement and has continued to lead the organization. Essentially, Saiban has sought to copy the informal sector's affordability, simple procedures, and rapid delivery, and join them with planned infrastructure including a sewerage system, a safe environment, legal title, and access to social services (Siddiqui). Three projects have created 6,000 affordable titled lots to reach 35,000 low-income urban residents. A comparable number of lots are in the pipeline. This total of 12,000 lots exceeds direct government production but represents less than one year of unmet need (new household formation) in the Karachi/Hyderabad area.

Saiban's City Of God project serves as an example. Saiban acquired a 100-acre site for a portion of the City of God project (KKB-3) from the Malir Development Authority on the outskirts of Karachi. This nonprofit organization subdivided the land on a gridiron plan consistent with government zoning regulations; 20% of the site was allocated for commercial services and collective functions (schools, medical clinics, parks etc.) and 30% for roads – much larger shares than informal subdivisions typically designate for these collective functions. The remaining 50% was divided into 80 square-yard residential plots.

The process to apply for and buy a lot is handled on-site and involves minimal paperwork. Saiban offers a flexible payment schedule consisting of a downpayment of 20% to 40% (about US$175) of the total price. Households pay the remaining amount of US$525 in monthly installments over 100 months. The resulting payments of US$5.25 per month are affordable even to the lowest-income households and virtually none drop out of the process. Saiban keeps ownership of the lot until the last payment, after which it delivers full legal title to the families. Saiban has also worked with commercial banks to offer mortgage finance to those earning US$3 per day and upwards.

In order to discourage speculation, Saiban requires that a poor family stay at a reception site for up to two weeks to demonstrate need. On making the downpayment at the end of the two-week waiting period, the family gains possession but not title to the plot, which is delivered to the family on payment of the final installment.

The initial infrastructure is minimal – partly to discourage speculation – and consists of communal water supply, a soak pit for sanitation, and public transport from private suppliers. The remaining infrastructure – including underground sewerage, piped water, electricity, and paved roads – is extended incrementally as installment payments are made. Saiban develops the infrastructure internal to the subdivision including underground sewer and water pipes, electric poles and wiring, and internal paved roads funded by the monthly installments from purchasing households. The relevant government agencies develop external infrastructure including trunk sewer lines, sewage treatment plants, bulk water and electricity supply, and access roads.

In addition, Saiban arranges for a wide variety of other services. Perhaps most important, Saiban transfers clear title to the lot when households make the final payment on their land and ensures public safety in its settlements through agreements with local police (usually, not to intervene) and others.

Financial analysis shows that a typical Saiban project (City of God KKB-3 of 2,800 lots) generates a highly positive net return (US$179,000 more than the total of the purchase cost of $430,000 plus subsequent development expenses of US$1.32 million). Thus, Saiban's *modus operandi* is financially viable and market-based. However, it depends on the sale of parcels from government to Saiban. Given the ample amount of urban land owned by the public sector, scaling up the Saiban model appears, in principle, a sustainable way to address low-income land and housing problems in urban Pakistan.

In practice, however, the large financial benefit to public officials of illegal subdivisions and of government "sites and services" projects has substantially slowed the expansion of Saiban's production. While the money Saiban pays to purchase public land goes to the government treasury department ("exchequer"), illegal subdividers pay under the table directly to individual government officials. Similarly, officials receive large commissions from contractors who over-design and over-estimate the cost of infrastructure for government sites-and-services projects, also under the table.

As a result, individual officials prefer to sell public land to clandestine subdividers for their own personal gain rather than Saiban. The founder and chair of Saiban – Tasneem Siddiqui – states that this organization has sought to purchase an additional site from the Malir Development Authority to expand Phase 3 of the City-of-God project near Karachi for the last three years. This Authority has yet to sell more land to Saiban. Illegal subdividers, however, have acquired the use of parcels adjacent to this Saiban project in collusion with the Malir Development Authority, the Board of Revenue, and the police. In Islambad, Saiban has yet to get permission to develop land purchased from private owners four years ago, while illegal subdivisions proliferate.

Analysis

Table 2 applies the hybrid value-chain framework to analyze the progressive subdivisions of El Salvador and Saiban's low-income land development projects in Pakistan. Each factor was rated on a scale of "0" (negligible/never) to "3" (high/always) along with a brief explanation. These ratings of individual factors were used to create average ratings for the settlement phase, the consolidation phase, and overall. An examination of these average ratings provides a broad assessment of each case:

The progressive subdivision system of El Salvador scored 2.0 (out of a maximum of 3.0) for settlement, 0.4 for consolidation, and 2.0 overall. The reasonably good score for settlement reflects that the progressive subdivision system of El Salvador allows 60% of new low-income households to acquire a lot in distant but developable areas. Although this system avoids extreme environmental hazards, it results in contamination of groundwater by unimproved pit latrines, the proliferation of vacant subdivisions, and significant legal and physical insecurity. The very low score for consolidation reflects these deficits and the minimal, haphazard support for turning these settlements into viable communities by extending infrastructure and for building shelter. Overall, the massive scale and good affordability compensated for the negative environmental impacts and the distant location of these projects to achieve an average rating of 2.0.

Saiban's low-income land development in Pakistan scored 2.3 for settlement, 1.9 for consolidation, and 2.2 overall. Saiban – an NGO – does a superior job not only at settlement but also in supporting consolidation over time of the resulting communities relative to the for-profit subdivision firms of El Salvador. The Saiban case demonstrates the potential value-added of citizen-sector organizations to the progressive housing process. However, Saiban's dependence on unreliable governments for acquiring new parcels ("political sustainability") and the resulting limits to scale resulted in an overall average rating only modestly above that of the El Salvador case (2.2 compared with 2.0).

Table 2 – Hybrid Value Chain Analysis of Progressive Subdividions in El Salvador and Saiban's Low-Income Land Development Projects in Pakistan

Phase	Step		Progressive Subdivisions El Salvador	Saiban Pakistan
Settlement	**I.**	**ACQUISITION AND OCCUPANCY OF A LOT**		
	a.	**Physically occupy lot** El Salvador – on signing rent to own contract, households (HHs) can immediately occupy lot Pakistan – after two-week processing/orientation period and making $175 down payment, quick occupancy of lot with minimum of paperwork	**3**	**3**
	b.	**Pay for lot** El Salvador – $15-$70 monthly payments affordable to great bulk of low/moderate income HHs	**3**	**3**

	Pakistan – monthly payments of $5.25 affordable to even poorest HHs		
	c. **Starter infrastructure** (e.g. communal standpipes/wells or "tanker" water, dirt roads, electricity) for occupation El Salvador – dirt roads, electricity and, sometimes, communal wells available on occupation Pakistan – dirt roads, tanker water and electricity available on occupation	**2**	**3**
	d. **Construction of an initial makeshift shelter** El Salvador – no support Pakistan – minimal support	**0**	**1**
	II. UPGRADING PROPERTY TENURE TO ACHIEVE SECURITY OF OCCUPATION		
	a. **Maintain physical control of the lot** El Salvador – 70% of HHs that sign rent-to-own contract to purchase lots complete process, 30% unable to maintain monthly payment and drop out Pakistan – virtually 100% of HHs complete process	**2**	**3**
	b. **Achieve secure tenure** El Salvador – rent-to-own contracts provide secure tenure for majority of HHS during payment period, but create legal issues for minority Pakistan – 100% of HHs maintain right to their lot during payment period	**2**	**3**
	c. **Full legal title** El Salvador – majority of HHs and projects are able to acquire full title on completion of payments, but a minority are unable to Pakistan – 100% of HHs receive full legal title from Saiban on making final payment	**2**	**3**
	AVERAGE RATING FOR SETTLEMENT PHASE	**2.0**	**2.3**
Consolidation	**III. PROVISION OF BASIC INFRASTRUCTURE**		
	a. **Upgrading** (e.g. road network, paving, drainage) El Salvador – minimal support provided by government over dacades Pakistan – Saiban builds infrastructure internal to subdivision as it receives HHs payments and arranges for government to build external infrastructure	**1**	**3**
	b. **Adequate sanitation** (improved pit latrines or sewerage) El Salvador – HHs build their own unimproved pit latrines Pakistan – Saiban builds internal sewerate, and government external sewerage	**0**	**3**

IV.	**CONSTRUCTION OF THE HOUSE STRUCTURE**		
a.	**Improvement and expansion of unit of owner occupant** El Salvador – no support Pakistan – minimal support	0	1
b.	**Addition of accessory units and spaces for relatives and rental income** El Salvador – no support Pakistan – no support	0	0
V.	**FINANCE OF STEPS IN PROGRESSIVE HOUSING PROCESS**		
a.	**Household savings vehicles** El Salvador – no support Pakistan – no support	0	0
b.	**Small serial short-term credit for –** **– purchase of lot** El Salvador – development firms finance payment of lot through monthly installments over 8-12 years Pakistan – Saiban finances payment of lot through monthly installments over 100 months	3	3
c.	**– infrastructure provision and connection** El Salvador – development firms neither finance nor provide infrastructure/services after provision of minimal starter infrastructure Pakistan – Saiban builds directly infrastructure internal to subdivision financed by HHs' downpayment and monthly installments, and arranges for government to build external infrastructure	0	3
d.	**– expansion and improvement of housing structure** El Salvador – no support Pakistan – Saiban has arranged for a small share of HHs that are formally employed to get private mortgage loans for house construction	0	1
VI.	**BUILDING COMMUNITY INSTITUTIONS AND COMBATING INSECURITY**		
a.	**Formation of neighborhood groups** El Salvador – no support Pakistan – minimal support	0	1
b.	**Metropolitan, national, and international NGOs support neighborhood groups** El Salvador – no support Pakistan – Saiban, an NGO, provides substantial support for settlement and consolidation	0	3
b.	**Neighborhood groups and/or NGOs partner with government and the private sector to increase physical and legal security**	0	3

		El Salvador – no support Pakistan – Saiban partners with government agencies such as local police to ensure physical security and guarantees legal security through delivery of full legal title on final payment		
AVERAGE RATING FOR CONSOLIDATION PHASE	**0.4**	**1.9**		
OVERALL CHARACTERISTICS		1. **SUSTAINABILITY**	**3**	**2**
		a. Scale El Salvador – serves 60% of new low-income HHs nationwide Pakistan – 70,000 lots developed or in pipeline far exceed government affordable-housing production, but serve only a modest fraction (less than 10%) of new low-income household formation		
		b. Financial El Salvador – development firms earn a return of 25% to 35%, approximately the national average for private sector Pakistan – Saiban generates a highly positive net return on each project, but this depends on purchasing government land at low prices	**2**	**2**
		c. Political El Salvador – since 1992, a government legal and procedural framework has developed that results in relatively rapid approval of projects and appropriate subdivision norms Pakistan – Saiban has difficulty in acquiring parcels from government as needed to supply its project pipeline, resulting in production substantially below Saiban's capacity and HHs' demand	**3**	**1**
		d. Environmental El Salvador – avoids the worst environmental problems that characterized illegal subdivisions prior to regulation in 1992 (steep topography, inappropriate soils, location near/on sensitive or hazardous sites), but without adequate sanitation resulting in ground- and drinking-water contamination, and vacant unsold subdivisions occupy large areas, displacing other land uses Pakistan – full infrastructure, especially sewerage, joined with good site characteristics and adequate location result in positive environmental impacts	**1**	**3**
	2	**LOCATION RELATIVE TO EXISTING INFRASTRUCTURE, SERVICES, AND JOBS** El Salvador – increasingly distant location often beyond urban periphery and in semi-	**1**	**2**

		rural areas Pakistan – on urban periphery		
	3	**TARGETING/AFFORDABILITY TO LOW-INCOME HOUSEHOLDS** El Salvador – affordable to bulk of low and moderate income HHs Pakistan – Saiban income criteria and selection procedures ensure targeting	2	3
AVERAGE	**2.0**	**2.2**		
OVERALL RATING				

Rating Scale for Level of Project/Product Support to Progressive Housing Process

0 = negligible/never
1 = low/infrequently
2 = medium/frequently
3 = high/always

This analysis suggests that citizen-sector organizations can, indeed, greatly improve outcomes in affordable housing and land development in emerging countries. However, nonprofits' dependence on government for resources – e.g. land parcels, administrative funding, and project subsidies – often limits their impact to a fraction of the potential. Thus, partnerships between private firms and the social sector must compensate local participants for their role, as do the bottom-of-the-pyramid programs of Cemex and Corona (Ferguson, 2008).

While these average ratings measure broad performance, the individual ratings show specific strengths, weaknesses, and ways to improve affordable-housing projects and products. For example, both of these cases scored low in Step 4 (Construction of the house) and step 5 (Finance of steps in progressive housing process). Hence**,** both could benefit by incorporating goods and services to streamline these steps (listed in Column 2 of Table 1). Packages of high-quality building materials, technical assistance in design and budgeting, and information to guide home improvement and upgrading of property tenure could facilitate construction of the house. Organizing savings groups, creating savings vehicles with a positive real interest rate, and microloans and supplier credit would help put in place the missing finance.

Poor scores on Step 6 (Building community institutions and combating insecurity) indicate that the progressive subdivision system of El Salvador badly lacks and could benefit tremendously from involvement of neighborhood groups and NGOs in consolidating these emerging communities. Such a citizen-sector component could take various forms. The four leading nationwide development firms might find that including support for community groups (e.g. land for/construction of a community center; a small share of households' payments as ongoing funding for a community association) raises the sales price and/or volume of their projects sufficiently to compensate for the cost. The great potential benefits of citizen-sector organizations in consolidating progressive of the subdivisions could also justify a public subsidy or a grant from a donor.

In turn, the analysis shows that Saiban must focus on land bottlenecks resulting from its dependence on purchasing publicly-owned parcels at low cost that limit its scale. For example, including some moderate-income households in Saiban's projects would generate a larger net return and the amount that the organization could pay for land, and allow this NGO to buy more privately-owned parcels. Working with a larger number of political jurisdictions could increase the competition among them for Saiban's services and result in greater access to government land. Campaigning for greater transparency in land-use decisions of government authorities would directly confront a core bottleneck – the corruption and mismanagement of publicly-owned land that limits supply. While such a confrontational strategy risks retaliation from these local officials in the short run, it has the potential to greatly increase land supply if higher levels of government make reform a priority.

Conclusion

Hybrid value chains provide a tool to analyze systematically affordable housing projects and products. El Salvador's progressive subdivisions and Saiban's low-income land development projects in Pakistan are cases in point. El Salvador has chosen to legalize and regulate market-based, land-development affordable to low-income households that, consequently, has expanded to massive scale. Although it avoids the worst abuses of clandestine development, El Salvador's progressive subdivisions continue to have many environmental, legal, and economic drawbacks. Government has developed programs and institutions to deal with some of these difficulties, but much remains to be done. In this regard, a crucial next step involves building partnerships with citizen-sector organizations and firms involved in land development and building materials supply in order to put in place other elements of the housing value chain.

Pakistan continues to allow the worst abuses of illegal subdivisions, which represent the only settlement option for most low-income household and, thus, the majority of the urban population of this low-income country. Saiban's projects demonstrate a far better market-based approach capable of massive scale. However, the benefits of illegality – particularly to local public officials in charge of land-use decisions – hinder its expansion. Saiban, an NGO, can expand its land development projects incrementally through applying different strategies. However, reaching massive scale depends on reform of land-use decision-making and the administration of the large amount of land owned by government.

This hybrid value-chain framework can also help orient the role that government inevitably plays in low-income settlement even when private-sector organizations (for-profits or nonprofits) function as developers. In effect, government must act to secure the inputs (listed in the Column 2 of Table 1) necessary to streamline the process. Government must galvanize and demonstrate, when necessary, the feasibility of private-sector initiative as well as regulate. The means include national legislation, reform of local subdivision and development review, programs, pilot projects, partnerships with the private sector, and transparency to combat corruption.

The conventional approach is for local government to regulate private development of new urban land. Even in El Salvador, which has relied mainly on this strategy, this passive limited role has proved insufficient. Practice and theory now coincide in finding that government must take a more proactive role to urban land than simply regulation in order to "enable markets" *(Global Urban Development Magazine*, November 2007; Freire et. al., 2007; Ferguson, 2007; Buckley, 2006). The hybrid value-chain framework identifies other actions that government must take for massive low-income land development: providing parcels for projects in cases where government owns much of the stock and land markets are paralyzed (e.g. Pakistan), promoting household savings vehicles and small housing credits, streamlining processes for securing intermediate tenure as well as full legal title, stimulating and working with neighborhood associations and nonprofit land/housing developers, developing neighborhood/police partnerships, and – most important of all – funding basic urban infrastructure and services.

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PUTTING THE "HOUSING" BACK INTO HOUSING FINANCE FOR THE POOR:

THE CASE OF GUATEMALA

Irene Vance

Introduction

In housing microfinance (HMF) circles it was envisaged that the unmet demand for housing would be met by a merging of the finance gap. Banks and mortgage lenders would go down market by making smaller loans to a lower-income clientele. Microfinance institutions (MFIs) would expand the size of loans and target clientele for their housing credits somewhat upwards.

Over the last decade, however, HMF appears to have grown mostly through microfinance institutions creating a home improvement product and, to a lesser extent, making modestly larger loans for new home construction and purchase. However, the supply of HMF by MFIs will most likely satisfy only a miniscule fraction of market demand in most countries even if it continues to increase at current rates for decades (see Ferguson's paper on housing microfinance in this issue of *Global Urban Development Magazine*). As the MFI industry has found technical assistance an unnecessary expense for microenterprise lending, MFIs have also tended to offer only microcredit for affordable housing without other products and services essential to expand this market.

HMF requires a much broader institutional platform than MFIs offer in order to expand dramatically to a scale relevant to demand in emerging countries. Regulated financial institutions such as commercial banks, in particular, but also housing cooperatives, and credit unions can help provide the broader organizational base necessary for expanding HMF loan volumes to massive size (see Magowan's paper on capital market funding of housing microfinance in this issue of *Global Urban Development Magazine*).

Banks have a number of comparative advantages in serving the poor and reaching economies of scale. These include extensive branch office networks, back-office support and I.T. platforms for internal controls, as well as access to their own financial resources from deposits.

Yet, while banks may recognize significant opportunities for expanding their market, they have been wary of housing microfinance because of the complexity of housing, and the perceived risk of offering loans to low-income families where land title is often absent. The experience of private commercial banks in microfinance – let alone housing microfinance – is still relatively limited (Baydas, et al 1997). According to a USAID study commercial banks globally has been reluctant to develop the capacity to deliver housing microfinance loans (Martin 2008). Exact figures are unavailable, but estimates indicate that at most a dozen of the 200 commercial banks currently offering microfinance globally extends housing microcredit.

Fortunately, the reluctance of banks to lend for affordable housing for the low/moderate income majority appears to be changing for a number of reasons. First, significant discussions about unbanked customers and the market opportunity to build new business models at the bottom of the income pyramid have intensified over the last five years (Prahalad 2004).

Second, the sheer size of housing demand as well as the strategic importance of housing credit in selling other products has caught the attention of banks and corporations. The World Resources Institute and IFC Corporation (2006) have quantified the global bottom of the pyramid (BOP) market at 4 billion people with an aggregate purchasing power of US$ 5 trillion, including around $400 billion of unmet demand for housing investment. More than half these families have no relationship with commercial financial institutions – not even a checking account. Banks have extended mortgage loans mainly for purchase of new developer-built units to the top 20% to 30% of the income pyramid, and left out even most moderate-income households, let alone the estimated 1 billion slum dwellers worldwide. The challenge is to bring a package of financial services that includes housing credit to scale to the BOP.

Yet finance is only one part of organizing an affordable housing value chain necessary to expand markets vastly. Typically, credit, alone, fails to stimulate a supply of high-quality, low-cost housing solutions. Finance must be joined with other housing-related products and services including land, title or other forms of secure tenure, quality building materials, construction technical assistance, basic services, and other ingredients to house the low/moderate income majority. No one organization contains the elements adequate for this task. However, business alliances among various institutions can create the packages of products and services necessary to produce a wide range of low-cost shelter solutions suited to the many housing submarkets used by the bottom of the income pyramid.

This paper profiles the experience of Guatemala's second largest commercial bank, G and T Continental, in housing microfinance and in assembling value chains in affordable housing production through business alliances.

The first part of the paper will examine the Guatemalan affordable housing context, the housing microfinance program of G and T Continental and how this bank joined micro lending with technical assistance in construction. This multiple services approach by a commercial bank provides some fresh insights on how and why to put the "housing" back into "housing microfinance."

The second section of the paper will describe the alliances that G and T Continental has established with the land developers, construction companies, and Guatemala's largest cement manufacturer to assemble value chains that offer a range of low-cost, high-quality housing solutions for low-income families.

Context and the Housing Microfinance Program of G and T Continental Bank

According to 2008 figures Guatemala has a population of 13 million. 56% of all Guatemalans live below the poverty line and 16% live in extreme poverty (World Bank). Housing is the second major expenditure after food, by the BOP at US $1.6 billion per annum, or US $911 per household (World Resources Institute, and International Finance Corporation 2006). From the perspective of building materials suppliers, this represents an immense market. However, from the standpoint of individual low and moderate-income households, this purchasing power falls far short of the amount necessary to pay for a mortgage to purchase a developer-built complete housing unit.

Hence, as in much of the rest of Latin America, few affordable housing options exist for the low income population. The majority must build their own homes "incrementally" or "progressively" largely funded with family savings over a period of 10-15 years (see Ferguson's policy introduction on the value chain framework in this issue of *Global Urban Development Magazine* for an analysis of progressive building).

In Guatemala the housing sector faces two critical challenges, a high deficit and low quality of existing houses. According to data from the Guatemalan Vice Ministry of Housing, the total housing deficit is 1.2 million units, and of these more that 700,000 make up the qualitative deficit. Approximately 20% of households lack one or more basic services and 25% of households suffer from overcrowding. Broken down by income, 591,167 houses are required for the poor and the extreme poor households and over 420,000 households for low-moderate income families (Velasco and Solo, 2008).

A lack of access to financial services generally and housing finance specifically exacerbates the shelter problems of the poor. 74% of Guatemalans are unbanked (7.1 million homes) and 55% of these have never completed a bank transaction (WRI, 2006). Access to credit is highly concentrated geographically, and by income segment. Areas near the capital city and main economic centers to the southwest use the great bulk of available home credit. According to UNDP report banks play a fairly minor role in providing credit to Guatemalans, whatever their income, most borrowers in all income groups obtain credit through informal sources (UNDP, 2007). However, studies carried out on behalf of DfID of the unbanked show that these households have considerable interest in gaining access to financial services (Velasco et al, 2005). This data illustrate the opportunities to expand credit services to the under- serviced regions and unbanked population.

Government funds are scarce, with an estimated 6% of national government's budget invested in housing by FOGUAVI. In the last decade, the number of MFIs has increased. Saving and loan cooperatives working in the affordable housing at market interest rates have also multiplied, although the supply of housing credit is still modest. According to World Bank estimates these financial institutions cover about one fifth of the demand for home improvements and basic services provision (Velasco and Solo, 2007).

Meeting this enormous unsatisfied demand for affordable housing will require the entry of new lenders and service providers appropriate for the many segments of the affordable housing market. Although lack of long-term capital is one of the most commonly-cited reasons for limited growth of housing finance, building retail capacity is equally important for achieving scale in housing microfinance. More distribution channels are clearly needed.

Given this context, the Swedish International Development Cooperation Agency (SIDA) has capitalized a second tier institution to provide both financial and non financial services to MFIs. SIDA has a long track record of working with low income housing initiatives in various regions from Central and South America to South Africa. In five Central America countries between 1998-2005, over US$52 million have been provided as catalyst start up funding to foster the development of innovative and sustainable models of micro-lending for housing with technical assistance in construction for progressive improvements, land titling, and new construction of housing, especially for families living in poverty. To date 110,000 families have accessed housing micro loans, representing 6.5% of the total urban poor population of the Central American region (Stein and Vance, 2007).

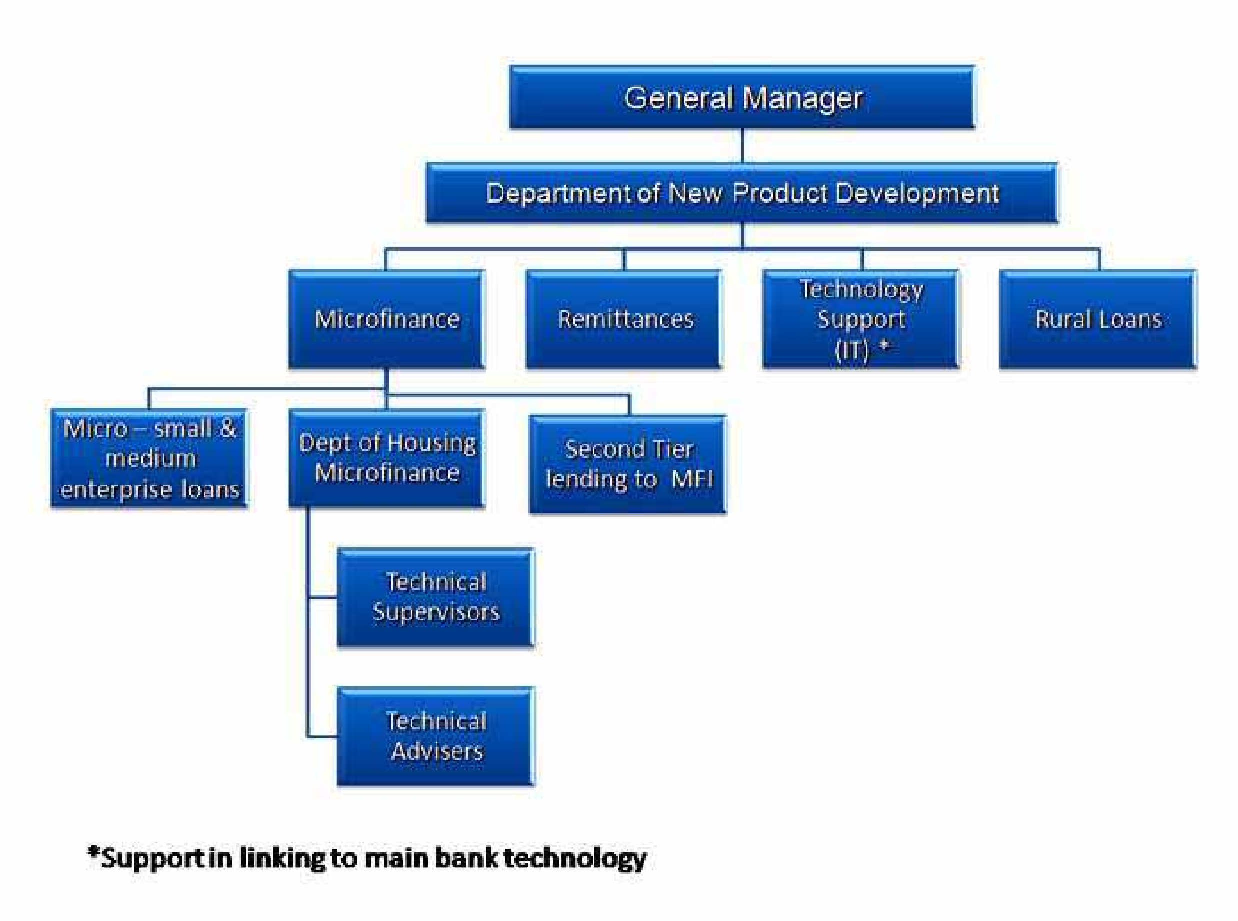
In Guatemala, The Trust Fund for Local Development in Guatemala (FDLG) a second-tier institution supported by SIDA, set up in 2000, has focused on the expansion of housing microfinance among a wide range of financial service providers. FDLG offers lines of credit as well as technical assistance to enhance in-house capacity of financial institutions and has brought together actors to create packages of products and services including housing microfinance to reduce the costs of progressive housing and add value for families – that is, complete the affordable housing value chain.

Currently FDLG works with 12 financial institutions; three rural development associations, four MFIs, four cooperatives, and most recently with G and T Continental Bank.

G and T Continental Banks' Housing Microfinance Program

G&T Continental Bank (hereafter, called "the Bank") is a member of the Financial Group G and T Continental. It is the second largest commercial bank in Guatemala and fifth in Central America with 44 years experience in the market. Traditionally, it has been one of the major mortgage finance providers. Currently it has 1.6 million clients, a portfolio of over US$1,660 million, more than 4,000 employees, 222 branch offices and services points throughout the country, as well as 26 branches in the United States, El Salvador, Costa Rica, and Panama. In 2006, the top management of the Bank took the strategic business decision to go down market to make smaller loans to lower-income households than it had customarily targeted.

A microfinance unit has been established within the existing institutional structure to take advantage of its extensive resources and systems. It forms part of the new product development division of the Bank, (as shown in the diagram below).



Creation of the microfinance unit within the Bank's structure has required a fundamental change in the culture of the Bank at all levels. A major part of the start-up phase of the microfinance unit has focused on the transformation of highly-centralized management systems to decentralized operations in order to ensure closeness to the client; one of the golden rules of success in microfinance. The General Manager of the Microfinance Unit, who previously managed a well-known Guatemalan MFI, has played an instrumental role in this change. The commitment of the Bank's top management and the resulting incorporation of microfinance into the organization's core mission have proved fundamental to laying a solid foundation that will lead to scale.

The general management for microfinance was in place by February 2006, and by July of the same year a pilot began in four branch offices. A specialized team to attend to the low income segment has been trained, both by hiring new staff from outside the Bank and re-training existing personnel. After the initial pilot phase, a process of decentralization of microfinance followed to 84 branches with 118 trained loan officers. Housing microfinance is currently offered in eight branch offices. Building an extensive new client base drawing from the unbanked population is central to the Bank's short and medium term strategy for expanding housing microfinance.

The Bank uses various "sub agents" for expanding its financial services to underserved clients and areas. Small and medium-sized registered business – gas stations, hardware stores, pharmacies or general stores -- serve as outlet points for a number of banking services, including loan repayments, payment of utilities, and changing checks, among others. This approach enhances banking services, especially in the interior and rural areas of the country, without the Bank incurring expenses in the expansion of its own infrastructure.

The Bank also offers credit lines to 12 MFIs for on-lending to low-income families. Although these credit lines with MFIs currently represent a small fraction of the operations of the microfinance unit (0.7%), they have strategic value for the Bank, the MFIs, and the underserved population. Through the MFIs, the Bank can provide services to customers in income segments beyond the Bank's normal reach; for example, through communal banks in rural communities. The MFI acts as an outlet for the Bank's products that the MFI cannot provide alone, such as deposits, which, banking laws prohibit unregulated financial institutions such as these MFIs from taking. As a result, customers enjoy a greater range of financial services. The MFI receives a commission. Hence, it is a win-win approach for the Bank, the MFIs and the customer.

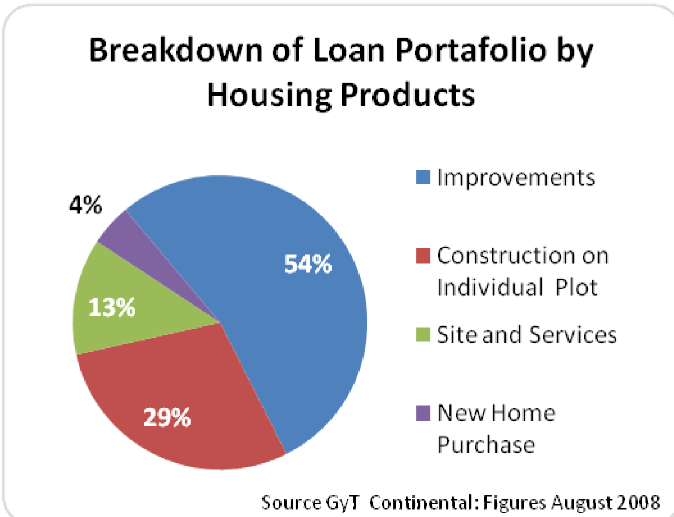
The Bank's target microfinance clients are families with a monthly family income between US$200-US$1,000, salaried employees or self-employed informal workers and families that receive remittances. Products and services include loans for micro and small enterprises, home improvement, expansion of existing houses, new construction on an individual plot, sites and services, and new home purchase. Additionally, the Bank offers its microfinance clients a variety of financial services, including current and long-term savings accounts, micro insurance, and pensions. The following table shows the main terms and conditions of the housing microfinance products.

Table 1.
Terms and Conditions of Micro Loans for Housing

Maximum Amount	US$21,000 – or US$4,800 for BOP
Loan Term	1-5 years – Housing Improvements 1-5 years – Site and Services Up to 15 years – Construction on Individual Plot and New Purchase
Interest Rate	16-18%
Banking Fee	1%
Guarantee	Fiduciary – up to US$6,000 Mortgage – over US$6,000 Mixed guarantees are accepted

Source G&T Continental, August 2008

Growth rates have been impressive. According to the *Economist*, G and T Continental now has the largest market share in microfinance in Guatemala (Economic Intelligence Unit, 2008). In the first 26 months the total active microfinance portfolio has reached US$102 million, and over 18,000 active clients. Microfinance represents 5.6% of the total active portfolio. The housing microfinance active portfolio is US$4.2 million, with over 1,700 active clients. The average housing loan is US$2,900, 66 % of the portfolio carries a five-year loan term, and 91% of loan guarantees are fiduciary. As shown in the follow chart, housing improvements is the main product, representing 54% of the loan portfolio, followed by construction on individual plot.



As in the rest of Central America, a very high share of households – 86% of Guatemalan families – have secure rights to a home or plot (although many lack full title to the property). In comparison, 61% of families in the EU countries and 69% in the US are homeowners.

This high share of homeownership suggests that the Bank's two main housing credit products – home-improvement and new construction on individual lots – target a mass-market including most low and moderate-income families.

Nevertheless, reaching the scale necessary for profitability presents numerous challenges for these products. Clients are dispersed rather than concentrated in new developer-built subdivisions. Thus capturing and attending each client's needs may add extra time to the loan application process. The extra step in technical evaluation of each individual client's needs can add to costs. Re-modeling existing units adds an extra dimension of complexity given that each improvement process is unique, thus solutions can be taken off-the-shelf less frequently.

In response to these realities, the Bank´s business model has two strategies for reaching low-income families: developing its own in-house capacity to provide micro loans that include technical assistance in construction with a streamlined method that offers personalized services to client needs; and through business partnerships with land developers, construction companies, and a large cement manufacture in a joint sales/loan processing strategy.

To date, the Bank's own in-house capacity of nine technical advisers has generated 50% of the HMF portfolio, almost exclusively housing improvements; the other 50% of the portfolio has come through its business partnerships. The next section will examine both these strategies and some of the preliminary outcomes.

Joining HMF with Technical Assistance in Construction

In microfinance circles, whether to include technical assistance or not is one of the unresolved debates. According to a recent review of Accion's International key MFI partners, provision of formal construction advice is not common (Mesarina and Stickney, 2007). The arguments for and against are numerous.

Many MFIs view technical assistance as inessential for eligibility or repayment performance (see Tilock´s chapter on technical assistance in Daphnis and Ferguson, 2004). From the perspective of the MFI, construction technical assistance falls outside the scope of their expertise. Further, some MFIs think construction assistance may negatively affect payments if there is poor customer satisfaction with the service or the quality of construction.

A small study commissioned by Accion International, of two MFI experiences in El Salvador has become the cited reference among those that affirm that technical assistance is superfluous, since it suggests little demonstrable difference in housing quality between houses built with or without formal technical assistance (Shumann, 2004). Interestingly, the same MFIs studied have continued to innovate and refine their technical assistance services. In summary, the minimalist approach, or "credit-only" housing product, assumes that access to a micro-loan is sufficient and that clients will rely on their own builders, which proliferate in the informal construction sector. Hence, in many cases, clients manage their home construction.

Advocates for the inclusion of technical assistance, argue that to ignore the technical challenges of low income housing provision is to ignore half the problem. Hence they urge that the "housing" be put into "housing finance." To do so microfinance providers will need to seek new business models to provide technical construction services directly, or indirectly, through other distribution channels.

There is a mounting body of evidence to show that unguided, self-help home construction constitutes one of the principal challenges of informal shelter and settlement. Unplanned construction, which characterizes progressive building of additional spaces in a piecemeal fashion, typically costs more due to waste of building materials, errors (e.g. crooked walls), poor use of available space, and lack of proper ventilation and illumination. It also often takes much longer – an average of 16 years to build a self built house in Mexico according to a CEMEX study. Household surveys and focus groups in a recent investigation sponsored by Cities Alliance and the municipality of Sao Paulo (2007) found that most Brazilian low-income families strongly want assistance in planning and construction of their home improvement, and many are willing to borrow at market rates to hire specialized labor for construction.

Technical assistance in construction becomes more important as the complexity and size of the work increases and as household incomes rise. Structural work such as pouring a foundation, adding a second story, building a new house, or altering a load bearing wall demands expertise. Particularly as rising earnings joined with social programs increase real household incomes for the BOP in many emerging countries (e.g. much of Latin America and Asia), families want and can afford to pay for technical assistance in construction and specialized labor. A study carried out by FIDEG, for the Foundation for Local Development, PRODEL in Nicaragua, which has over a decade of experience in combining micro loans and technical construction assistance, shows that not only are families willing to pay, the service has additional add value, particularly for women heads of households, in cost opportunity, since they have neither sufficient knowledge of building or time to supervise the work of the hired mason (FIDEG, 2006).

From a business perspective, joining technical assistance in construction with other elements of the affordable housing value chain (credit, a quality building materials, title, urban services, remittance services etc.) increases the market size for each of these components (see Ferguson's policy introduction on the value chain framework in this issue of *Global Urban Development Magazine*). In contrast, providing only one of these essential products or services without integration into a package holds much less value for households. For example, CEMEX concluded that offering only cement -- its core product -- would generate much lower cement sales than a package of quality building materials (including cement), construction technical assistance, microcredit, and a savings program in order to construct a major home addition more quickly at lower cost (typically, building a bedroom). Not surprisingly, Mexican families really value a bedroom and not the cement to build a bedroom. This market study laid the basis for this company's award-winning *Patrimonio Hoy* program (see Schmidt's paper in this issue of *Global Urban Development Magazine).*

The decision to join HMF with technical assistance in construction also depends on institutional perspective. An MFI that extends mainly small home improvement loans and considers HMF a secondary adjunct product to its central goal of microenterprise finance (the norm for MFIs with HMF products) may well have little incentive to add technical assistance in construction. FDLG, in Guatemala and PRODEL in Nicaragua encourage all the MFIs to provide the service either as part of their own non financial services or through outsourcing, especially since each recognize that there is a huge unmet demand for specialized building construction services for the poor, and these services generate employment in the construction sector. A large commercial bank responsible for financing major home improvements, construction of new units, urban infrastructure and services, and other aspects of much of a metropolitan area and that values housing finance as part of its core mission has a compelling interest in the quality of the result.

How can technical assistance be packaged efficiently and effectively for both the provider and the customer? Does technical assistance have added value for all types of progressive improvements? Is it viable for financial institutions to provide this as an in-house service or is it best outsourced to specialist NGOs in the private sector? These are among some of the most pressing questions that are addressed in the business model of G&T Continental, a bank that considers that technical assistance is key in the housing value chain.

From the outset the housing loan product was designed to include technical assistance in construction, provided by the Bank's in-house capacity to families to whom they grant micro loans for progressive housing improvements. The Bank considers that technical construction assistance adds value both in the pre-credit and post-credit process as well as providing a better quality housing solution suited to the needs of the client. Hence technical assistance is justified for several reasons: clients often do not have sufficient knowledge of pricing, quality or quantity of building materials required to prepare an accurate budget. Frequently they rely on a local informal sector builder, which greatly raises the risks of inaccuracy; over-budgeting or under-budgeting are not uncommon.

The setting up of the technical assistance facility has been supported by FDLG. In addition to the credit line for lending to families in the US$200-US$600 income segment, a grant from FDLG has assisted building capacity for construction technical assistance within the Bank, covering a six month pilot and start-up phase.

Financial institutions that offer in-house construction assistance can do so in several ways: by adding technical advisers as a separate service in addition to loan officers; or by combining the two skills. The former can add to cost, since the processes of loan application, and the review of technical building aspects are carried out in parallel by two staff members. The Bank has opted to combine the two skills. The advisers have a background in technical drawing and construction, and have been trained in microcredit analysis. Other important qualities are knowledge of the local language, and an understanding of cultural norms. The Bank has also trained loan officers in the fundamentals of some of the key aspects of technical assistance to the client, namely the review of the budget and the building materials; which are verified against the building plans proposed by the builder. In this way the loan officers are part of the sales force and can provide the core advisory services. Technical assistance is classified according to the complexity of the progressive improvements, and the type of product e.g. site and services or construction in an existing plot and also be the type of guarantee. Technical construction assistance is charged to the client, as part of the interest rate, and represents one percentage of the loan amount. All clients receive the following technical assistance:

(i) pre credit site inspection: The site inspection is part of the due diligence and loan assessment process, to ensure that the proposed improvement, or land purchase (in the case of sites and service) is both technically feasible and in function with the capacity to pay. For progressive housing improvements and new construction on an existing plot, a detailed plan, or a detailed sketch of the proposed improvement is prepared. Client preferences are taken into account, although often the value added of the technical assistance at this early stage is to help the client´s decision in giving priority to most urgently needed improvements to safeguard structurally sound building, over personal preferences, and, in the case of new construction on an existing plot, guidance on how to position the unit to allow for a logical sequence of subsequent additional rooms in the future. A timetable is prepared, and verified.

(ii) a second visit takes places a week after the loan disbursement: this follow up ensures that the loan has been invested in housing, that building work is in progress, and/or provides orientation to the mason, or family members.

(iii) a third visit is carried out to verify the building work is executed according to plan, and provide orientation to the mason, or family members.
(iv) a final evaluation is made with the builder and the family.

Business Alliances for providing Housing Loans at Scale

One of the challenges of housing microfinance is how to generate sufficient growth to be profitable. Even though some repeat borrowings can be expected, sustained growth depends on capturing new clients, expanding to new areas of operation and providing new products. Reaching scale with housing loans that carry construction assistance adds an extra dimension of complexity to both scale and financial sustainability. The Bank's in house capacity with nine technical advisers can reach 30 new clients per month to their portfolio, generating some 150 new clients per month, and each adviser can manage a pool of 300 clients on a roll-on, roll off basis as new and old clients enter and complete the building work. The Bank's aims to attend to several, rather a few thousand clients, annually; according to its business plan housing micro-loans will represent 15% of the total portfolio in the next five years.

Housing finance providers can establish strategic business partnerships with a variety of construction companies and building materials suppliers to market housing microfinance. From the outset, forming business partnerships has been central to G&T Continental´s housing microfinance strategy. To date, partnerships have been established with 14 firms; seven land developers, five large and medium construction companies as well as the largest cement manufacturer in Guatemala, *Cementos Progreso*.

The partnerships have three objectives. First, alliances with the land developers and construction companies seek to enhance the ability to reach a larger number of customers without expanding extensively the Bank´s human resource base. Training and employing partners' sales force to prequalify loans and construction projects can provide the Bank with a steady supply of viable loan requests and cover a wider geographic area, effectively. In the pilot phase, the construction companies showed that they could double the number of clients captured by the Bank, essentially because of their large network of sales staff.

Second, diversification and new product development; alliances facilitate offering a wider range of low-cost housing solutions – land purchase, site and services, construction on existing individual plot and progressive housing improvements – than the traditionally limited offerings of completed units by construction companies.

Third, the Bank's partnership with land developers, local builders, and building material suppliers create economies of scale in at least two HMF products – housing improvements and construction of houses on individual plots. To tackle these two products at scale will require new hybrid value chains.

Essentially, these partnerships recognize that assembling the major components for the delivery of affordable housing – land, infrastructure, services, finance and technologies – demand new business models for families further down the income pyramid.

G and T Continental has been involved for many years in mortgage finance so a number of the partner companies have previously worked with the Bank. Nevertheless, the companies involved in this new business model are vetted by the Technical Unit in order to assess top management's commitment to working with low-income families, and willingness to adopt a methodology which includes training staff to carry out pre- and post-credit technical services to customers. For larger companies that have traditionally built completed units, this implies a significant shift in working arrangements. The sales staff works within the communities; their role is more akin to social promoters since they work closely with the families assisting potential clients prepare the loan application. As a result of the joint sales strategy the construction contractors can double the number of clients per adviser because they generate all the relevant information from potential clients.

The partners companies' technical staff also offers the clients the same technical assistance services that the Bank offers its individual clients. This is possible because the Bank has trained the construction companies' staff in the application of a set of standardized formats, which cover: assessment of housing needs, house layout (in the case of improvements) and different design options (in the case of new construction). These are part of the pre-credit process undertaken irrespective of the housing solution: land purchase, site and services, and housing improvements.

The Bank's Technical Unit carries out the following checks, prior to loan approval, during the building work, and post construction.

ü Assesses the technical and financial quality of the proposal.
ü Evaluates the adequacy and appropriateness of design, pricing, quality and suitability of materials according to climatic factors.
ü Reviews the budget
ü Assesses the appropriateness of the proposed solution against low income household needs, checks the plans, building permits etc.
ü Site inspections one week after loan disbursement and at the conclusion of the building work.
ü Prepares technical reports from the site inspection, providing feedback to the constructor.

The Bank's Technical Unit charges the developer/constructor for its services including a one-time fee for each approved design, which goes to cover costs of the Unit. At present, costs are modest given its small size; by 2009 the number of professional staff will increase, but to no more that three-to-five staff, as well as additional technical advisers. The General Manager expects to reach a breakeven point for construction technical assistance by 2009.

What are the benefits of the joint sales strategy and the technical assistance? From the Bank's perspective the technical assistance in construction services and supervision enhances the homeowner's satisfaction, increases the market for housing microfinance by improving the efficiency of home construction, and shortens the time of progressive building. Loan applications can be processed more quickly and disbursements made within three-to-five days of presentation of paperwork. Hence, business alliances for technical assistance are time effective. In addition to savings in time and resources and a greater potential for scale, the General Manager notes that technical assistance builds customer loyalty.

From the client's perspective, the household enjoys savings in cost and quality of service. From the perspective of the developer, the partnership of joint sales and technical assistance produce a constant flow of clients.

The business alliances also enhance the understanding of customers' values, and help to create a more tailored product. Each company offers different housing solutions appropriate to the various sub-segments of the low/moderate-income housing market. A more detailed examination of three of the Bank's partnerships will illustrate this added value.

ADPROSA

ADPROSA has been in the land development/home construction business for 12 years and is the largest home builder in Guatemala. According to the General Manager 1% of all developer constructed homes in Guatemala have been built by ADPROSA. From its inception the company has sought to provide options for low/moderate income families; the first project were homes of US$5,000. It is one of the key partners in the joint sales strategy with the Bank for going down market. ADPROSA has taken the lead to date in building on individual plots – one of the two main housing credit products financed by the Bank.

This program, called *GUATECASA,* is a new concept for ADPROSA because it recognizes that low income families need flexible solutions that fit with the different stages of household growth and income. ADPROSA´s market studies indicated that, especially in the interior of the country, plot owners have paid for their land and gradually saved modest amounts for future construction, but had scant knowledge or access to credit.

Working closely with local land developers and community leaders ADPROSA´s sales staff identifies a critical mass of potential clients, sufficiently concentrated in one area. Clusters of 10 to 15 clients are needed to be viable. Local land developers know the clients and their credit history. ADPROSA does the paperwork for loan application, credit screening, technical appraisal and design options, coordination with local building suppliers and supervising the building work.

Cost saving technologies and economies of scale are key factors in reducing costs and maximizing the loan. Large companies are well placed to develop products that can reduce the time of building progressively by using modular prefabricated materials. However, one of the major limitations of new technology is the lack of acceptance by customers. In Guatemala, as the rest of Central America, low-income families prefer reinforced cement block. Typically a unit of 49 square meters, built in traditional reinforced concrete block, would take two-to-three months to construct. By adjusting the internal production chain, ADPROSA has been able to complete the building work in 28 days. A range of seven house designs is available, from a home starter module, apt for incremental progressive building to units of 54, 70, and 116 square meters. Prices range from US$12,000 to US$15,000 and up to US$20,000.

Sites and services is a less expensive option for low income families to obtain a first foothold in the housing market. Historically, site and services projects throughout Latin America have typically produced disappointing results, especially under government programs. ADPROSA offered site and services between 1998-2000, producing more than 6,000 solutions, including land, water, drainage and electricity, with three walls, in a "U", leaving the fourth wall to be completed by the family – a basic solution. ADPROSA has re-initiated its site and services product within the Bank`s housing micro lending scheme; ADPROSA has available land throughout the country. Joining a housing plot with serial micro loans and construction technical assistance shortens the time necessary to build a unit and ensures that the home is built to technical specifications. A revamped new generation of site and services is likely to respond to low income households where overcrowded conditions and weak purchasing power persist.

The traditional core business of large construction companies is to produce large scale projects. Addressing some of the key challenges embodied in the housing needs faced in developing countries will require an assembly line technique to lower cost and improve quality, applying an approach that combines logistics, management and technology. Large housing schemes, even when costs have been reduced to fit the affordability criteria, have failed on several counts to meet low income people's needs. In particular, large housing schemes fail to include key amenities and services that make the resulting projects habitable. Using economies of scale, (production of 50-60 units per month), ADPROSA has been able to produce homes that include all basic utilities (water, drainage, electricity, paved streets) as well as an impressive range of community services; fully equipped schools, police station equipped with patrol units, day care centers, bus stops, recreation space, marketplace with stalls for small businesses and 24-hour security services. Homes in these urbanizations are priced between US$12,000-15,000.

Low income families require flexible solutions and in line with their capacity to pay that can grow in size according to the different stages of the household cycle. It is not uncommon for a family to forgo investments in housing until first securing the education of children. ADPROSA offers a range of house types within the same neighborhood – small start up units, at 30 square meters, and two and three room units in which space has been allocated for small business. The income from home based business recognized that the home is a productive unit, and the income generated goes toward the repayment of a housing loan. ADPROSA also offers a buy-back policy, allowing families whose purchasing power over time increases and thereby permits them to move up the housing ladder by buying a new larger unit within the same neighborhood. Staying in the same location is important to low-moderate income families who tend to choose to live near to the place of work, and maintain family and social networks that are important social capital in times of economic shock (Moser, 2007).

With rapid urbanization, the availability of low cost land suitable for residential use has become the major barrier to housing for the low income population. According to ADPROSA, currently the cost of urban land in Guatemala represents 15-20% of the cost of a house. In 2007, ADPROSA began the first social-interest housing built vertically; apartments of 49 square meters. ADPROSA aimed for a technological solution that would reduce construction time as well as land costs. Using modern construction technologies a thousand solutions can be produced in six weeks. Each project includes schools, market, commercial areas, parking, church, security, and is priced at US$17,000. The goal is to create communities, close to the city, strategically located near to places of work.

The business alliance between the Bank and ADPROSA is mutually beneficial for both partners and this hybrid chain responds to the needs of various segments of the low income market. From the Bank perspective, tapping the strong sales force that ADPROSA can mobilize for marketing housing loans provides a robust platform for taking housing micro finance and housing finance products and services for low-moderate income households to scale effectively and efficiently without additional costs to the Bank.
ADPROSA`s diverse range of commercial housing solutions (including land parcels) respond to the price demands of different sub-markets, including the segment of households with incomes high enough to jump the frontier between informality and formality as well as new poor households that need a first foothold in the housing market. They have been able to package products for families that already have a plot but lack finance and a readymade housing solution that is affordable and expandable. Hence ADPROSA has broken the traditional mould of limited options above the capacity and willingness of the poor to pay.

There is mutual interest for both the Bank and ADPROSA to produce high quality, solutions that with an inclusive technical assistance approach for clients needs. It will enhance client's willingness to pay and foster customer loyalty. For ADPROSA a continual stream of financing of low income clients represents a sustained volume of business and for the low-moderate households a greater choice of options for meeting their housing needs.

Cementos Progreso

Cementos Progreso, CEMPRO, is a major family-run company with over a century in production of cement and building materials products in Guatemala. CEMPRO began to explore the possibilities of servicing the BOP market in 2005, and launched its pilot program, *Su Hogar y Progreso* program*,* in November 2007 in alliance with the Bank. The CEMPRO business model is based on the premise that this cement manufacturer/retailer can add value in two areas of the housing value chain: on the one side, the manufacture and supply of high quality materials and on the other, by working with the local informal sector labor force and families in the self build progressive house construction process.

CEMPRO prospects and identifies clients, screens local builders, supplies the building materials, provides design options, and supervises the local builders. Unlike the CEMEX *Patrimonio Hoy* program in Mexico, which provides credit in the form of delivering building materials prior to payment, CEMPRO does not offer or manage the loan. Rather, it has a team of 24 promoter/advisers that work in client outreach, principally facilitating the creditworthiness analysis and preparation of the loan application for the Bank. According to CEMPRO, their market studies show that clients are highly interested in having a house built in less time. The *Su Hogar en Progreso* program offers nine design options, including a house-kit. Two of the designs are for incremental construction or an initial starter home for extremely poor families.

CEMPRO has introduced a prefabricated block technology which preserves the same appearance as traditional concrete block. The prefabricated model achieves a cost savings of 25-30%, chiefly as a result of the reduced amount of reinforced steel required, and the speed of assembly. Construction of a 36 to 44 square-meter unit can be completed in less than two months instead of three. To date CEMPRO has provided 800 solutions. The target for 2009 is 3,000 solutions, the breakeven point.

The kit homes were assembled through family labor, with supervision from CEMPRO staff. However, results from the pilot phase indicate that more skilled labor is required, since the process is too complicated for the do-it-yourself builder. CEMPRO developed a user manual but results were less than expected. It would seem that manuals are less effective methods for community education in building skills. In Tamil Nadu, India, the Indian Association of Savings and Credit offered a course on cost effective construction methods to its clients. A survey revealed that only 5% who attended the class incorporated the course concepts of cost effective methods into their building methods and thus the class was discontinued.

CEMPRO has concluded that prefabricated systems are challenging from the construction standpoint in the short term but promising for large projects in the long-term. For the Bank the key lesson from the CEMPRO experience is micro loans to support the formation of small builders companies together with training and preferably with certification by the Chamber of Construction would greatly improve the standards of building and help to close the enormous gap between the informality of the low income housing market and the formal commercial building industry, as well as generate employment in the construction sector.

SECORINSA

SECORINSA is a small construction company set up in 2007 with support from the Bank. The general manager has over 30 years of experience in one of the largest commercial construction firms. SECORINSA´s business goal is to specialize in progressive improvements, which represents a massive proportion of the bottom of the income market. The major challenge in packaging a product for progressive housing improvements is the heterogeneity of the types of improvements which limits the possibilities to standardize solutions – in any one neighborhood at a particular time, loan requests will cover a multiplicity of construction activities, the addition of an extra room, a tiled floor, replacement of a roof, as well as the building processes of the poorest households that build a wall at a time. SECORINSA keeps fixed costs to a minimum by maintaining a small core staff, and works closely with community leaders to identify clients in a concentrated area to achieve volume. They also uses local supply chains to obtain favorable rates on building materials. These suppliers are often small business firms that are borrowers with the Bank. There are mutual benefits for all, competitive prices for SECORINSA, which has added value for the families and increased sales for the suppliers.

In the pilot trial SECORINSA has generated a housing portfolio of over US $800,000 in new clients, and carried out 150 housing improvements. Although SECORINSA is in the initial stages of product development (CEMEX reached 75,000 clients after five years), the joint strategy with the Bank and SECORINSA may shed light on two traditional problems, how to manage risk and how to distribute low value, high volume products for low income families.

Conclusions

The low-income housing products and services that G and T Continental and its business alliances are bringing to the market are innovating in several ways

- ***Diversification of housing products that meet the needs of different sub-segments of the bottom of the income pyramid.*** G and T Continental Bank and its partners show that commercial banks can assemble packages for housing improvements, sites and services, and new construction with various price tags ranging from US$5,000 – US$25,000. As a larger number of financial institutions and private sector construction companies recognize the needs of different segments of the low income housing market, and diversify products for different sub markets, this would go a significant way in bridging the gap between housing microfinance and housing finance in general for the poor. Over time the two markets might merge. The expansion of housing options at different prices, as a function of the capacity to pay, is the flexibility that low income families require to facilitate different entry points to the housing market. Hence the break with the traditional "one size fits all" mentality for addressing low income housing is one of the major breakthroughs both for the construction sector and commercial banks

- ***Joint sales provide a basis for rapid growth***. The joint sales and marketing methods appear to be a cost effective strategy to reaching a greater number of clients. The partnership approach recognizes that no one entity has the ability to provide all the pieces that make up the housing value chain given the complexity of housing finance outreach, where closeness to the client is crucial. Marketing housing finance requires more intensive promotion than traditional microfinance and may be a factor in explaining why housing microfinance portfolio size generally is small. Marketing capacities need to be sufficiently robust to be able to extend to new geographic areas since the frequency of repeat loans is also much lower than in microfinance. G and T Continental´s strategy of alliances with a number of companies is geared to managing scale and future results will depend to some degree on the internal capacity of the Bank, to receive and process the volume that this platform could generate. Appropriate information systems for managing large numbers of housing transactions including technical assistance records, still need to be developed.

- ***Provision of technical assistance in construction at scale is set to be the next key innovation that would revolutionize the quality of progressive housing improvements.*** When talking of scale in housing finance circles this almost always refers to and is synonymous to scale lending. Much less attention has been given to exploring mechanisms to scale technical construction assistance services, a key non financial service. Yet, this article has presented some compelling evidence which suggests that technical assistance could be one of the missing links in the housing value chain. Technical assistance provision not only will impact on the quality of low income housing, but for the Bank, in the absence of real collateral it provides tracking for cost recovery and building client loyalty. The incremental housing process raises a whole host of technical challenges, and to date most MFIs have chosen to avoid, yet, the SECORINSA experience suggests that the formation of small building companies that can offer efficient technical services for housing improvements and incremental building has possibilities to help lenders make their way down the income pyramid, by mitigating some of the perceived risk inherent in microloans to the informal housing market.

· ***Reaching scale***: Likewise, the entry of the construction companies, material suppliers and cement manufacturers to provide more holistic services shows promise in both enhancing scale, and the quality of housing for the poor should continue to improve. Good construction practices decreases housing costs and increases the value of the home, which is the key asset of the poor. As the ADPROSA examples shows, large construction companies have the capacity to innovate with new technologies which can deliver housing sooner and cheaper to low income families, and which could go a long way in expanding solutions for the vast numbers of potential clients. New technologies at scale are also part of the housing chain that potentially can tackle the affordability barrier for moderate income families. In all three cases, ADPROSA, CEMPRO, and SECORINSA there is evidence of what Prahalad indicated were some of the principles of business innovation for the bottom of the pyramid markets – focus on hybrid solutions and blending old and new technology.

· ***New distribution channels.*** The expanding number of firms entering the under banked market with innovative products gives reason to be optimistic that companies entering this market can meet the needs and criteria of the low to moderate income families with innovation and profitably. The financial services industry may be better placed to reach scale in housing finance through partnerships than a “stand alone” credit only product. Alliances between banks and the construction sector, similar to G and T Continental appear to be the growing trend to meet the market opportunity of the BOP. CEMEX’s *Patrimonio Hoy* program, initially provided the loans in materials, but it is now seeking to work with financial institutions to manage the lending operations. Mi Banco, Peru works with building material suppliers, and Holcim, a large international cement company has partnerships with NGOs and local supplier networks. The growth of new distribution channels for both loans and housing products entering the under banked market with appropriate frameworks is well positioned to provide low-moderate housing on the required scale.

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HOUSING MICROFINANCE: IS THE GLASS HALF EMPTY OR HALF FULL?

Bruce Ferguson

Introduction

Donors, governments, microfinance networks, and foundations have promoted housing microfinance ("HMF") for a decade. Considerable operational experience has accrued on this practice over this time. Meanwhile, many emerging economies have grown rapidly, which has changed housing markets and the context for HMF. The moment, then, is auspicious for a re-examination of housing microfinance and its record.

How have microfinance institutions performed at housing lending? Is HMF still relevant to the enormous challenge of low-income housing and urban development in emerging countries and, if so, how can it be expanded to massive scale?

This paper answers these questions by analyzing recent survey data on housing microfinance, examining the housing economies and HMF practice in three countries that display a wide range of experience (Peru, Mexico, and Brazil), and profiling cutting-edge cases of market-based low-income housing delivery that include HMF. This paper mainly deals with Latin America, where HMF has advanced the most, but also draws on evidence from other regions. A short description of the emergence of HMF prefaces this investigation:

HMF has become "hot" largely for two reasons:

First, HMF has the potential to serve most low and moderate-income households. These families neither want nor can afford a large long-term traditional mortgage to purchase a developer-built complete unit. Instead, these households build progressively, by acquiring and upgrading title to a lot, building a makeshift shelter, replacing this makeshift shelter with permanent materials and expanding it, and lobbying government for services (Ferguson, 2003; Greene and Rojas, 2007). A series of small short-term loans can fund the steps in this progressive housing process with payments affordable to households.

The prototypical HMF loan consists of a small, short-term unsecured credit (US$500-$2,500 with a term of two to five years, depending upon context) to a homeowner to expand or remodel their informally-built house. Sometimes, microfinance institutions (MFIs) offer somewhat larger loans (US$3000-$7000) at longer terms (five to 15 years) for a family to construct a new home (often on a lot that they already own), occasionally secured by a mortgage. Small home improvement credit, however, is the main market for which microfinance institutions have created a housing microfinance product.

However, small credits could also finance a wide range of other housing investments useful to low and moderate income households. These include lot purchase, title regularization, construction of a floor/joist/roof structure that the homeowner builds out, adding rental units onto the homeowner's property through horizontal or vertical expansion, individual and communal infrastructure, the vertical or horizontal buildout of a developer-built core unit or humid core (a bathroom/kitchen area containing plumbing and electricity) in pre-programmed steps, or the completion (adding fixtures, cabinets, electrical equipment, additional plumbing, painting etc.) of an unfinished condominium shell in a high-rise building. This paper will mainly deal with the supply and demand for small home improvement loans, which has become virtually synonymous with "housing microfinance." However, these other possible applications of housing microcredit will be considered when strategizing how to expand HMF to relevant scale.

Social support programs joined with GDP growth have stimulated a rapid increase in household income of families in the bottom half of the income pyramid in many emerging countries over the last decade -- including Peru, Mexico and Brazil. This paper will also examine how this rise in family income has diversified housing investment of low/moderate income households beyond small home-improvement and the implications for HMF.

Nonetheless, the potential market for small home-improvement loans remains huge and, often, relatively uncontested; 50% to 80% of the population in most emerging countries build their homes progressively. Market studies typically show that one-quarter of these families want and can afford a small home-improvement credit at any one time. Although each individual project is small, the huge numbers result in an impressive total market potentially financed by such credit -- $331.8 billion worldwide according to the World Resources Institute (see their paper in this issue of GUD magazine). Traditional mortgage finance institutions have typically lacked the low-cost community-based systems necessary to lend to this market. Hence, microfinance institutions have frequently faced little institutional competition in extending HMF to these families.

A <u>second</u> reason that HMF has become a developmental "hit" involves its fit with the microfinance industry. Small home improvement credit offers a useful product that microfinance institutions can add to their core business – micro-enterprise lending. MFIs can successfully apply their existing loan methods and installations for micro-enterprise loans to small home improvement loans with little or no modification. Roughly 20% of funds nominally borrowed for micro enterprise go to housing improvement in the absence of an explicit housing product.

HMF also fits well with the transformation of many MFIs from NGOs into financial institutions that are regulated because they take deposits from the public. The aspiration to own or build a house has historically proved the main motivation for families to save in developed countries (where "savings and loan" societies have traditionally linked these functions) as well as emerging nations (where savings clubs and housing cooperatives have emerged for the same purpose). Hence, adding a home-improvement credit as well as a savings products makes sense for MFIs seeking to take deposits – the least-expensive type of funding -- and become regulated financial institutions.

Small serial credits largely for building materials to improve a homeowner unit – which has come to be called "housing microfinance" – began expanding a decade ago mainly because of these synergies with the microfinance industry. By this time, roughly 200 microfinance institutions worldwide had become commercially viable (Robinson, 2001). Increasing competition had caused microenterprise loan markets to tighten in some countries (e.g. Bolivia, Bangladesh). Diversifying into home-improvement lending and savings products appeared useful next steps for leading MFIs and their networks. Major figures – such as Hillary Clinton – lauded the achievements of the "microfinance revolution", and the concept of "housing microfinance" enjoyed legitimacy by association.

In addition, a series of events, papers, and a book (Daphnis and Ferguson, 2004 – republished in Spanish in 2006) on housing microfinance during this period disseminated awareness of HMF throughout the international housing community and microfinance networks, and brought these two audiences into communication for the first time.

This conjunction of factors pushed and pulled the microfinance industry into low-income home lending. The next two sections of this paper assess how MFIs have done at this task.

Summary data on the current state of housing microfinance within the microfinance industry

Two recent studies present comprehensive empirical data on the state of housing microfinance. Both focused on Latin America, the region where this practice has advanced the most. The first – by Accion (presented in Messarina, 2006; and Merrill and Messarina, 2006) – surveyed 10 of its regional affiliates in Latin America. The second – by Micro Service Consult Gmbh (GmbH, 2005) – was commissioned by Housing Microfinance Ltd., a financial group planning to issue securities to finance low/moderate income housing in order to assess market demand from MFIs for funding. The GmbH study surveyed 25 of the top MFIs in Latin America on their housing credit products and plans.

Although conducted independently for different purposes, these two studies arrive at highly-similar conclusions. Discussing each in turn:

From 2002 to 2005, the HMF portfolio of the ten Latin American Accion affiliates surveyed grew from US$38 million to US$117 million, and home improvement lending increased from US$20 million to US$74 million. Interestingly, almost as many of these Accion affiliates offered home purchase loans (70%) as home improvement loans (80%), indicating that microfinance institutions ("MFIs") are seeking to serve moderate-income households that buy a new unit as well as low-income households that upgrade a lower-cost housing solution.

The HMF portfolio grew from 12% of the total portfolio of these 10 microfinance institutions to 19%, but still represented only 9% of the total network portfolio of Accion. Repayment rates on the HMF portfolio of the surveyed MFIs were superior to that on microenterprise lending. This datum bears out the impression of many microfinance lenders that households prioritize repayment of housing credit over microenterprise credit.

These 10 MFIs surveyed by Accion stated that HMF loan demand is immense. Most of these MFIs do not market this product, although some competition is beginning to emerge from building materials suppliers and finance companies. This finding jibes with the conclusion of a market study conducted in three Mexican cities (Capital Advisors, 1999) that bordered the US that the effective demand for HMF totaled four times that for micro-enterprise finance in this same geographic area. Fifteen percent of Mexican households surveyed by this study both wanted and could afford a small loan at market rates with short terms for home improvement. The general sense of lenders is that roughly half the households of Latin American countries are interested in improving or adding to their homes, although only about a third of this half of the population can afford market-rate finance in a given moment.

The Accion study concluded that HMF has proved useful to build customer loyalty, but is not a core product of these ten MFIs. The core mission of these MFIs continues to be fostering economic development through micro-business lending. In general, these MFIs do not view housing as an integral part of this core mission.

The GmbH study showed that 17 of the total 25 MFIs surveyed had products for low-income housing, while the remaining eight were seriously considering developing such a product in the short run. These institutions had extended a total $84.2 million for housing loans. Overall, housing loans represented 8.8% of the total micro loan portfolio of these MFIs. Housing credit accounted for over 15% of the portfolio in only three of these MFIs. Despite this small share, many of these MFIs valued housing credit because it fits with well within their overall business strategy. HMF helps to diversify their portfolio, and meets the housing credit need of their existing client base of micro entrepreneurs.

All 17 MFIs with a housing product surveyed by the GmbH study make loans for home improvement, but only nine offered finance for purchase or construction of new homes. Maximum maturities lie between 10 and 20 years for MFIs offering new home loans and between two and five years for MFIs offering home improvement loans. The average loan amount was $1,925. Almost all institutions funded their housing loans at least partly from their own equity. Eleven of these 17 institutions used credit lines mainly from national public banks and international development banks for refinancing their housing portfolio.

The institutions surveyed by the GmbH study were interested in roughly doubling their housing credit volume over the next three years, although their core mission continued to be micro-enterprise credit. This expansion would raise their housing loan volumes from 8% to 10% of their total loan portfolio to 15% to 20% – a significant increase but hardly a dramatic one relative to the immense demand for this product.

These MFIs surveyed by GmbH said the "lack of availability of appropriate funding" was the most important constraint for the expansion of their housing portfolio. However, donors, investment banks, and others have flooded the microfinance industry with liquidity. Hence, such "lack of funding" statements may sometimes indicate other problems (such as high costs and inefficient operation that make funding at competitive rates unprofitable for these MFIs) and, therefore, deserve analysis on a case-by-case basis. These MFIs cited lack of institutional capacity and technical know-how as the second most important problem in limiting the expansion of their home lending. Given the multiplicity of sins that "lack of appropriate funding" often indicates, technical assistance to remedy institutional and operational problems appears to be as important as simply more or better funding.

Other recent studies of HMF within MFIs by International Habitat for Humanity (Stickney, 2006) and the Cooperative Housing Foundation (Schumann, 2006) come to findings consistent with these conclusions.

From the perspective of promoting HMF in MFIs, the glass is half full

Hence, these studies show rapid growth of HMF loan volume within MFIs, although from a minuscule base. MFIs have discovered that HMF is profitable and has immense potential for expansion. Thus, HMF – particularly small home improvement loans – is now well established as a recognized niche product for MFIs. From the perspective of many MFIs, their housing product is on track to fulfill its institutional missions: to diversify risk, support development of savings products and the transition to a regulated deposit-taking financial institution, and offer an additional product popular with their core micro-entrepreneur clients.

The "lack of funding" constraint – which MFIs cite as the main bottleneck to expand housing microfinance – is also on its way to solution. For example, Mexico's second-tier housing development bank, the Sociedad Hipotecaria Federal (" SHF"), which previously offered liquidity only for mortgage loans mainly for middle-income home purchase, has had an HMF window since 2005 and now offers a subsidy that can be joined with the HMF loan (as discussed below). The government of Colombia has also tried to start a secondary market for housing microfinance. Investment groups and capital market institutions are establishing financial vehicles to fund home credit of MFIs. The paper by James Magowan in this issue of *Global Urban Development Magazine* describes the considerable progress in issuing securities on public markets for on-lending to MFIs to finance low/moderate income housing in emerging countries. These major achievements deserve recognition and further support in order to consolidate them.

However, three interrelated factors seriously limit expansion of HMF within MFIs:

First, an explicit housing product typically has a slightly lower interest-rate and longer tenor, and can cannabalize their existing microenterprise loan business. That is, the MFI's microentrepreneur clients could nominally borrow for housing to fund their business and get better terms than they would under a microenterprise credit. Thus, the end result of developing an explicit housing product might mainly be lower profits, unless marketed to a new clientele or unless the MFI monitors the use of the funds for housing.

Second, the Accion and GmbH studies confirm that microfinance institutions consider housing an adjunct secondary product. From the perspective of most MFIs, housing credit deserves little attention and is unrelated to their core mission of "promoting economic development." Many studies as well as common experience show that most households build wealth mainly through homeownership and housing investment plays a crucial role in national economies. Nevertheless, microfinance institutions continue to relegate housing to a trivial role in their business strategy aimed, supposedly, at "economic development." With a few notable exceptions, MFIs lack the interest to make housing a major focus.

Most fundamental, however, the microfinance industry offers far too small an institutional base in most countries for the expansion of housing microfinance to a scale relevant to demand, even if MFIs were interested in this role. The next section explores this fundamental institutional bottleneck in Peru, Mexico, and Brazil.

From the perspective of satisfying household demand and addressing the low-income housing and urban development emergency of the next three decades, the glass is more than half empty

The supply of HMF is still only a minuscule fraction of demand. Even if HMF continues to grow at current rates within MFIs, the total loan volume will be trivial relative to demand in most contexts over the next 20 to 30 years – that is, the peak of the world's low-income housing/urbanization emergency (see Cohen, 2005).

The following profiles the housing economies and HMF practice in Peru, Mexico, and Brazil in order to illustrate the range of experience in ramping up HMF and to explore alternatives for addressing low-income housing needs on a market basis at massive scale.

Peru

Peru is a country of 27.5 million people, with 54% living below the poverty line. The population of the capitol – Lima – has increased from 1.5 million in 1960 to around 6 million currently. Gross national product grew at 5.35% in the third quarter of 2005, with inflation of 3.65% on average in 2004. As regards housing demand, 57% of the residents of Lima want to improve their house. In the south of Lima, 42% of roofs are of zinc or fiber. In the south and east of Lima, 26% of floors are made of earth. The housing deficit has been calculated at 1.2 million units, and is increasing at 90,000 units annually (Gwinner, 2005a).

Government has a number of housing programs (Gwinner, 2005b). One of these – BanMat – makes "loans" for building materials. However, arrears rates are about 80% on these credits. A second program – MiVivienda - is funded by a 5% tax on salaries. MiVivienda channels these monies through a second-tier finance institution, COFIDE, to first-tier housing lenders that – in turn – extend below market-rate credit to around 14,000 middle-income households per year for the purchase of new developer-built homes costing US$25,000 to $50,000. A third program, Techo Propio, operates by joining a direct demand subsidy (i.e. a grant) with the household's downpayment and – if necessary – a loan for purchase of a new home, construction of a home on a lot owned by the family, or rehabilitation of their existing home. The subsidy amount varies from US$1,200 for home improvement to US$3,600 for purchase of a new home. Techo Propio currently delivers around 3,000 subsidies per year to households earning around US$400-$500 per month.

Overall, Peru has housing conditions and a set of governmental housing programs that are fairly typical of Latin American countries. The great bulk of the housing subsidy and finance system – the MiVivienda program in the case of Peru – focuses on middle income families and fuels the commercial homebuilding and mortgage industries. These programs contain significant subsidies per unit that limit their scope and production to a small share of the population – mainly middle-income families. The implicit government policy for the low-income majority is for these households to invade land or purchase a lot in a clandestine subdivision or low-income community and to build their home over many years without formal-sector support.

In short, Peru is particularly fertile ground for small serial home credit. A conservative estimate is that pent-up market demand totals US$1.1 billion for housing microfinance loans from 550,000 existing low income households, and is increasing at $20 million annually from 9,000 new low-income families.

MiBanco – the largest microfinance institutions in Peru and in Latin America, – has responded by creating one of the largest and fastest-growing housing microfinance businesses in emerging countries. MiBanco was formally launched in 1998 as a licensed bank when it assumed the loan portfolio of Accion Communitaria del Peru, a nonprofit NGO operating in Lima. Today, MiBanco is the largest microfinance bank in Latin America and one of the largest banks in Peru. MiBanco has recently won an award as one of Latin America's most successful commercial banks.

The impetus for creating a housing product dates back to the experience of senior management in helping to finance and rebuild houses in northern Peru destroyed or damaged by an earthquake in the early 1970s (Brown, 2003). Funding limitations precluded extending credit for housing before the organization became a commercial bank. In 2000, however, management began designing a product for market-rate finance of home improvement, called MiCasa. Management decided that the MiCasa loans would be offered through the same branch network with the same staff as their other loan products. The core part of the credit process – the evaluation of the client’s capacity to repay -- would be essentially the same for housing as the bank’s micro enterprise loans. There were two targets for MiCasa loans: MiBanco’s traditional customer base of micro entrepreneurs, and low-income, salaried workers living in the same communities. By adding low income workers to its target market, however, MiCasa has ended up serving poorer households than the micro-enterprise portfolio of the institution.

Credits – averaging US$1,600 – are extended for up to five years at interest rates of around 45% in the Peruvian currency (Soles), a somewhat lower rate than that for micro enterprise loans. Borrowers, however, typically pay off ahead of the loan maturity; actual terms average 20 months. MiCasa was envisioned as a microcredit product without technical assistance for construction. Currently, however this program assists households with the construction process through an initial design and budget, one visit at the start of construction to help orient the work, and a technical report on the feasibility of construction. MiCasa serves households, extends credit, and collects repayment through its regular system of loan officers, each of whom manages a portfolio of around 250 loans and gets paid largely on commission based on loan origination and collection performance.

Loans are secured mainly by cosigners, personal collateral, and temporarily taking custody of households' proofs of ownership until credits are paid off, rather than mortgages (only about 10% of MiCasa loans are secured by a mortgage), which are time-consuming and expensive to secure and impractical to execute in low-income areas where home resale markets are thin. Thus, assiduous methods of loan collection and maintaining good credit in order to get access to more finance constitute the main incentives for repayment.

MiCasa has grown rapidly. In 2001 – its first full year of operation – MiCasa made 5,000 loans. In 2006, MiCasa made 13,498 loans. As of April 2007, MiCasa had 20,903 loans outstanding in total, and was making new loans at the rate of US $2.5 million per month. Arrears exceeding 30 days were 1.81% -- low by Peruvian and international standards. Return on equity was 7% to 9% per annum – which, when leveraged by the institution's capital-to-asset ratio, resulted in profits of over 20% per year. From April 2006 to April 2007, the MiCasa loan portfolio grew at virtually the same rate (42%) as that of the loan portfolio of MiBanco as a whole (40%). MiCasa constituted 12% of the total portfolio of MiBanco.

According to the manager[i] of MiCasa, effective demand for these micro housing loans is huge, and far exceeds the supply of loans under the MiCasa program. This manager notes that the first priority of MiBanco as a whole continues to be micro enterprise lending, although the institution also actively markets MiCasa.

Recently, MiCasa has attempted to establish alliances with building materials suppliers, which are still at a beginning stage. For example, MiCasa has opened an office of five people within a building materials supply store associated through overlapping ownership interests with one of the largest cement producers of Peru -- Cimento Lima. This office has extended credit of around US $300,000 for purchases of building materials. Large international companies - such as Ace Home Center (US based) and Sodimac (Chile based) increasingly dominate the building materials retail sales environment in Peru.

MiCasa also has a pilot urban upgrading loan project. Under this program, loans have been extended for a total of around US$300,000 for infrastructure provision, including installation of water and electric networks, to six groups of households in various low income communities, which collectively agree to repay the loan. These loans are being repaid on time, and two of the six groups of households have repaid their loans fully.

Although the partnership with the building materials supplier and the urban upgrading loan project are still embryonic, the manager of MiCasa believes that these initiatives hold the future to expansion of housing microcredit in Peru.

With the success of MiCasa, a number of other local financial institutions – particularly cooperative credit societies (Casas Municipales) and other MFIs – have now introduced housing products similar to MiCasa and are beginning to explore this market. This competition has contributed to forcing down interest rates on housing microfinance loans, from around 70% per annum three years ago to 45% currently.

Of the three countries profiled here, Peru represents the "best case" for the argument that housing microfinance can become relevant to the scale of the urbanization/low-income housing challenge. On a flow basis, Peruvian MFIs appear to be extending roughly the amount in HMF loans – US $20 to $30 million per annum -- necessary to cover demand from new families. However, little progress has been made in satisfying the huge pent-up demand from the past. The housing micro credit volume extended by all Peruvian MFIs over the last decade totals less than US $150 million compared to a pent-up market demand of US$1.1 billion.

Mexico

With a population of 110 million, Mexico has 30 million households, growing at a rate of 750,000 families per year. Forty percent are low-income, earning up to three minimum salaries – about US$450 per month.

Mexico has made great progress in traditional mortgage finance over the 15 years since the Tequila Crisis of 1994 virtually destroyed the private housing finance system led, at that time, by commercial banks. An institution funded by pension contributions of private workers mandated by federal law, INFONAVIT, lends at below-market interest rates largely to low-income formally-employed workers and still dominates the Mexican mortgage market, accounting for roughly 60% of mortgage loans.

In 2002, the federal government created a second-tier housing development bank – SHF – to lead the development of private market-rate housing finance. Under its organic law, SHF enjoys the support of the federal treasury necessary to build a private housing finance system, which phases out over a period of 12 years in order for the private sector to assume full responsibility. SHF has been the main funder and de-facto regulator of 17 mortgage banks, called housing "SOFOLES" (SOFOLES can lend but not take public deposits for a single asset type – in this case, housing) that filled the gap in mortgage finance left by the exit of commercial banks after the Tequila Crisis.

These housing SOFOLES have innovated successfully in their origination and collection methods, and became the main home lenders to moderate and middle-income families. The success of housing SOFOLES has, since 2004, begun to re-attract commercial banks back into home lending. The largest housing SOFOLES are now turning into commercial banks so that they can take deposits from the public and better compete in a more contested mortgage market. Other housing SOFOLES are branching out into new products – including unsecured lending for home improvement – by converting into a new category of financial institution, called a “SOFOM”, which allows diversification of asset types without taking deposits from the public.

INFONAVIT, SHF/SOFOLES, a number of other government housing finance institutions, and – recently – commercial banks have joined to increase mortgage lending dramatically in Mexico over the last eight years, which has more than tripled to around 500,000 loans per annum. These mortgages mainly finance the purchase of new homes built by sophisticated commercial housing development companies, which have become some of the most efficient and largest-scale homebuilders in the world. This system is constructing many new residential subdivisions of 10,000 to 20,000 houses with complete infrastructure on the periphery of the major metropolitan areas of Mexico. These new commercially-developed homes mainly consist of core units that the family can expand horizontally and vertically in pre-programmed steps.

Despite these striking successes, roughly 40% of households – who are largely low- income and employed informally – lack access to institutional housing finance and fall outside Mexico's housing system. As a result, a large market exists for small home credits for home improvement. Based on a market study (Capital Advisors, 1998) that shows 15% of Mexican households want and can afford such loans, unsatisfied HMF pent-up demand in Mexico is roughly US$9 billion, and growing at US$330 million per annum.

The Mexican MFIs sector is somewhat underdeveloped. The MIX – a microfinance database – lists only 27 institutions versus 40 in Peru, a country of only about one quarter of Mexico’s size (Elias, 2008). Seeking to diversify from its customary middle-income clientele, SHF has established a facility for offering credit for first-tier lenders to fund HMF loans and has recently added a subsidy program that can be joined with these home microcredits. One Mexican MFI – Financiera Independencia – is assertively expanding the HMF market, mainly through joining SHF’s HMF credit and subsidy facilities. Box 1 profiles this experience.

Box 1 -- Financiera Independencia in Mexico; leveraging housing micro finance with government subsidies without contaminating credit markets

Joining mortgage finance, government grants, and a household down payment has worked well for assisting middle-income households and stimulating mortgage lending and commercial homebuilding for this segment. Such "direct demand subsidy programs" have a long history in emerging countries, particularly Latin America (Ferguson, 1996).

However, combining housing microfinance with government subsidies has proved elusive for low-income households. MFIs frequently distrust governments and are concerned that the availability of subsidies will dilute borrowers' willingness to pay on microcredit. In turn, government housing bureaucracies frequently emphasize increasing housing production numbers, pay much less attention to cost recovery (e.g. repayment rates on loans), and do not understand the perspective of MFIs. Largely for these reasons, attempts to join HMF with housing subsidies have failed in Columbia, Nicaragua, and elsewhere. A Mexican MFI, Financiera Independencia, and the federal government second-tier housing Bank, SHF, have succeeded in joining these two sources of funding on a large scale for the first time.

Financiera Independencia is an MFI incorporated in Mexico as a Sociedad Financiera de Objeto Multiple ("SOFOM"). Since its inception in 1993, FI has grown to include a network of 128 branches in 30 of the 32 Mexican states. The institution offers four products, including a credit line for home improvement called CrediConstruye.

FI introduced CrediConstruye in 2007 funded by a US $80 million line of credit from SHF that expires in 2011. FI is the first MFI to use this SHF housing microfinance facility. Borrowing households must have low incomes – below 4 minimum salaries (approximately US$600 per month). Loans must be used for home improvement and all are extended in the form of a voucher that can be exchanged for construction materials. The average loan size is US$600. Loan terms are two years with an interest rate of 43% per annum.

Virtually all of these loans are joined with a subsidy, typically of US $400 per household, under the Esta Es Su Casa program of the Mexican federal government. CONAFOVI – the apex housing policy organization of the Mexican federal government – has delegated the administration of this subsidy to SHF.

As of December 2007 after one year of operation, CrediConstruye had disbursed US $32.7 million in loans to 20,000 clients. Arrears rates for 90 days were 2.5% – low by both Mexican and international standards. FI anticipates quadrupling loan volume and number of borrowers served by the end of 2008.

The management of FI has found no problem with borrowers confusing subsidy and microcredit, and attributes the smooth operation of the program to the SHF grant process. While housing agencies unfamiliar with banking operate most housing subsidy programs, SHF is a second-tier housing Bank with long experience working with the private sector. SHF has largely succeeded in developing a private housing finance market for middle-income households in Mexico. The institution has now begun to focus on bottom-of-the pyramid housing finance markets.

Sources: interview with management of FI, June 24, 2008; and Elias, 2008.

The CreditConstruye program of FI shows that joining housing microfinance with housing subsidies can, indeed, dramatically increase loan volumes without contaminating credit quality.

Government subsidies, however, are a limited resource. Even if the FI/SHF partnership with accompanying subsidies were to quadruple to $120 million in loans per annum as planned for 2008, it would satisfy only a miniscule fraction of the US$9 billion of pent-up demand for small housing credits in Mexico. Other commercially-viable Mexican MFIs have shown little interest in housing. In summary, the relatively underdeveloped Mexican MFI industry lacks the capacity and interest to satisfy a significant fraction of demand for HMF in that country. The efforts of the SHF and FI are highly promising, but have a long way to go to reach a scale relevant to this market.

While small housing credits are a niche secondary product for most MFIs, they are vital to the business of Mexico's enormous building materials manufacturers and retailers, such as CEMEX (the third-largest cement manufacturer in the world) and Home Depot of Mexico. These modern corporations must provide consumer finance for their products to be competitive. The experience of the Patrimonio Hoy program of CEMEX of Mexico illustrates the likely evolution of housing microcredit in large markets, such as that of Mexico – see Box 2 for a description. This case has received wide attention within the building supply and manufacturing corporate sector in Latin America, in particular, but also throughout emerging countries.

In effect, Cemex's Patrimonio Hoy program merges small credits with other components of the low-income housing value chain – including building materials, a savings program, and technical assistance in construction. The integration of these elements greatly expands the market for each one. Typically, no one organization can provide all these elements. Hence, as Patrimonio Hoy demonstrates, this integration comes from alliances among various entities – corporations, citizen-sector organizations, and government.

The expansion of housing microfinance to scale depends fundamentally on the creation of such business alliances. Irene Vance's paper on HMF in Guatemala in this issue of *Global Urban Development Magazine* provides a good second example of creation of a low income housing value chain through business alliances organized by a commercial bank. A third intriguing example is that of a building materials manufacturer, Corona, of Colombia, which provides very small credits (US$400) to the poorest households for ceramic tile to replace dirt floors, also documented by a paper in this issue of *Global Urban Development Magazine* by Gutierrez.

Home Depot of Mexico – the largest retailer in this country – also provides consumer credit for 12 to 18 months for purchase of its building materials, although without integrating other aspects of the progressive housing process. The consumer credit extended by the Patrimonio Hoy program of Cemex, alone, has exceeded US$400 million, compared to the US$120 million in loan volume to which FI aspires by the end of 2008 for its Creditconstruye program.

Thus, consumer credit for the purchase of home construction materials represents, by far, the main source of low-income housing finance in Mexico and has an enormous institutional platform for growth – the world-class Mexican building materials manufacturing/retail industry. In comparison, home improvement lending through microfinance institutions is miniscule and only one commercially-viable MFI is aggressively pursuing this market.

Box 2 - Patrimonio Hoy in Mexico

The Patrimono Hoy Program of CEMEX, the giant Mexican cement maker, serves do-it-yourself homebuilders, who account for 40 percent of the consumption of cement in Mexico. CEMEX research showed that low-income homebuilders in Mexico take four years to complete one room, and 13 years to complete a 4-room house. This slow rate largely reflects the lack of formal-sector support. So, many households join informal savings clubs (*tanda*) in which each family pays US$10 to a pool and one member is selected each week by lottery until all have received money. However, this informal savings and self-help construction has strong drawbacks when unguided. Building materials dealers often sell these households poor quality materials left over from large customers at high prices. Homebuilders who lack construction skills often waste materials by buying too much or too little. They also hoard these materials, which leads to their deterioration by weather and loss from theft. Home design and construction is often poor quality. Finally, *tanda* savings often end up getting used for festivities rather than invested in construction materials.

The CEMEX Patrimonio Hoy program addresses these problems with self-help construction with the business goal of expanding CEMEX sales in this market. It first organizes small groups of families who commit to a 70- to 86-week saving program. As informal tanda, each group's members take turns collecting payments and playing the role of enforcer. To ensure that savings get spent on construction materials, however, families receive raw materials rather than cash. Deliveries start after only two weeks, before families have saved much, and subsequent deliveries are made each 10 weeks. Thus, CEMEX is, in effect, advancing microcredit to these families in the form of building materials. CEMEX operates this program through establishing "cells" – four-member offices – located in low-income communities. CEMEX arranges with local building materials suppliers to deliver high-quality product and uses its cells to orient groups of households in the construction process. Rather than use advertising, CEMEX hires local "promoters" – 98 percent of them women – to inform local households about the program. These local women are the key to establishing the relationships and developing the trust necessary for the program to work in the challenging environment of informal communities. The program sponsors parties and other events to celebrate completion of a room or a house.

The average do-it-yourself homebuilder in Mexico spends US$1,527 and takes four years to build an average size room of 100-square-feet. But participants in Patrimonio Hoy can build the same size room, with better quality, in less time – 1.5 years – and at two-thirds the cost (US$1,038, which includes the cost of materials, technical assistance from an engineer or an architect, and Patrimonio Hoy club fees). Patrimonio Hoy reached 100,000 people in its first two years of operation, and planned to expand this number to 1,000,000 by 2008. Patrimonio Hoy operates without subsidy. SHF – the secondary housing-finance liquidity facility of Mexico charged with leading the development of market-rate home credit – has established a window for housing microfinance that works with Patrimonio Hoy and other first-tier lenders. CEMEX has operations in 23 countries, and management are interested in expanding Patrimonio Hoy outside Mexico.

Sources: interview with management of Patrimonio Hoy; and Prahalad, 2005.

Brazil

In contrast to Peru and Mexico, Brazil has virtually no commercially-viable microfinance institutions. Nonetheless, small credit for housing is a huge industry and finances roughly one-fifth of housing units in the Sao Paulo area, comparable to the number of units funded by Brazilian institutional mortgage finance in this metropolis.

These small housing loans mostly take the form of consumer credit channeled by building materials retailers for the purchase of their products. However, this building-materials consumer credit industry is fragmented, disorganized, and charges relatively high interest rates. An examination of Brazilian housing finance and its building materials consumer credit industry provides important insights into small serial credit for progressive housing in an environment without microfinance institutions.

One million Brazilian households form each year and enter the market for housing (Ferguson, Cherkezian, and Motta, 2007). Over half of this demand for new housing comes from low and moderate-income households earning below five minimum wages – about US $650 per month. Self-financed progressive housing accounts for 62% of new Brazilian housing investment. Much of this self-financed progressive housing development occurs in the informal sector.

As in Peru and Mexico, economic growth joined with social support programs have expanded the lower middle-class and decreased the number of households in abject poverty over the last three years, stimulating demand for housing investment. According to *The Economist,* “between 2000 and 2005 the number of Brazilian households with incomes of US$5,900 to $22,000 grew by half, from 14.5 million to 25.3 million, while those receiving less than US$3,000 a year fell sharply to just 1.3 million.”

Although growing at a rapid rate recently, mortgage finance is still small in Brazil, both relative to the share of housing funded and to GDP. Table 1 compares mortgage finance as a share of GDP in Brazil with that of other countries.

Partly because of the low penetration of institutional mortgage finance, many Brazilian households pay for a surprisingly large share of their housing in cash. Downpayments of 30% to 50% are common. A wide variety of “alternative” sources of housing finance have also developed.

The main sources of institutional mortgage finance are the SBPE (Sistema Brasileiro de Poupanca e Emprestimo) (averaging about 20% of mortgages for purchase of new homes) and the CEF using FGTS funds (averaging about 60% of mortgages for purchase of new homes).

Table 1 -- Mortgage Finance As a Share of GDP

Country	Mortgage finance as a share of GDP
Argentina (2001)	4%
Brazil	2%
Bolivia (2001)	8.6%
Chile (2001)	10.8%
Columbia (2001)	7.0%
Indonesia (2007)	3%
Malaysia (2007)	25%
Mexico	2%
Panama (2002)	24.4%
Peru (2001)	2.9%
Uruguay (2001)	7.0%
United States	79.6%
European Union	42.6%

Sources: Galindo and Lora in Inter-American Development Bank 2005; and Unitus/Lehman Brothers, 2007.

The remaining medium and long-term home funding (20%) comes from three "alternative" non-bank sources: direct financing from developers, real estate "consorcios" (federally-regulated savings clubs that pool funds gathered each month and allocate them to one or more members to buy a house), and housing cooperatives (groups formed by groups such as churches that help to organize the process of saving, accessing land, construction, and home purchase of their members).

The SBPE (Sistema Brasileiro de Poupanca e Emprestimo) provides a government guarantee to individual savings deposits, but places limits on the rates paid for these savings that are below market. In turn, banks are required to lend most of these sums in the form of long-term mortgages at below-market rates.

FGTS (Fundo de Tempo de Garantia de Servicos) collects each year about 4.5% of GDP through a levy of 8.5% on formal private-sector wages -- a greater share of the economy than any other housing finance/pension mandatory contribution system in Latin America . These amounts are credited to accounts of individual workers and accrue interest at a low rate. The CEF (Caixa Economica Federal) – a government-owned institution that is the largest retail bank in Brazil – lends the great bulk of FGTS funds in the form of below-market rate credit. CEF offers two programs; one for borrowers acting as individual households, and the other for borrowers acting within the context of a group.

The SBPE has mainly financed middle-class housing, with an average loan amount of R. $81,503 (2006) – about US$27,000. The FGTS/CEF has largely funded moderate-income housing, with an average loan amount of R. $20,021 (2006) – about US$6,500. In terms of numbers, the SBPE reportedly financed 115,823 housing units in 2006, while FGTS financed 304,882 in this year – a boom year for housing construction and finance that saw volumes and numbers of units financed reportedly increased by over 50% from the averages of 2001 to 2005.

Brazil has begun to build a sizable mortgage finance industry and a modern housing economy with some world-class homebuilders (e.g. Gafisa) modelled on their Mexican counterparts (e.g. Geo, Urbe) that serve these countries' emerging lower middle-class as well as upscale markets. Nonetheless, as new annual household formation in Brazil runs at one million, these two main mortgage sources (SBPE and FGTS) left a gap of more than half of all new households unassisted by mortgage finance even in the boom year of 2006.

In terms of both numbers and volume, the bulk of FGTS finance went to "microcredit" ("microcredito") for a package of building materials, with an average loan size of R. $4,901 (about US$1,630). However, these government-funded housing microcredits have a number of serious problems that make their label of "microcredito" misleading. Most fundamental, they occur at highly-subsidized rates of interest. In addition, many households consider such government loans as partly gifts, and do not pay them back. Such unscrupulous competition from the government has almost completely undermined commercially-viable microfinance institutions in Brazil.

The total amount funded under this housing "microcredito" program – R. $827 million (US$276 million) – is also insignificant relative to the annual investment in progressive housing – R. $62 billion (about US$20 billion), let alone the additional sums needed to improve the inadequacies of the existing housing stock.

As a result, private consumer credit for building materials purchase is big business in Brazil. Brazilian Federal law requires that commercial banks invest 2% percent of their demand deposits in "microcredit" of some sort. The law also regulates the amount, maximum interest rate, and term of this microcredit funded by commercial banks. As regards housing, these banks either offer this housing microcredit directly to their depositors or channel this microcredit through building materials stores.

Two studies have recently examined this industry, one commissioned by Ashoka (Leonardo Letelier and Soares, 2007) and one contracted by Cities Alliance and the municipality of Sao Paulo (principal investigators: Frederico Celentano and Alex Abiko, 2007).

The Ashoka study surveyed 12 local building-materials stores, 237 households and conducted a number of household focus groups in two favelas in Sao Paulo. Virtually all households in these two favelas owned their own home. The municipality has provided basic services in these favelas and 91% of households intended to improve their homes through expansion and/or remodeling. Families prioritized price, financing, store brand, and distance from their house as the main factors in choosing stores to purchase building materials.

Half of all purchases were made in cash. Families financed about a third of purchases mainly using consumer credit but sometimes with a credit card, either their own or of a friend. These stores reported that their sources of financing typically qualified customers for a maximum of US$1,500 in credit – the average cost for the building materials to add one room. These building materials stores offered credit of their own by accepting two to three monthly installment payments.

These stores also channeled bank credit for materials purchase at market rates (3.5% to 6% per month) with 12 to 48 monthly installments, and offered negligible amounts of highly subsidized FGTS housing "microcredit" (at 0.5% per month, with up to 96 monthly installments) due to its scarcity (and reported nonpayment rates of 30% on such "microcredit" government programs). These interest rates for consumer credit compared to market-rate mortgage interest rates of around 15% per year at the time, with inflation running around 4% per annum. For many reasons, Brazil has historically had some of the highest real interest rates in the world, which plague economic activity, in general, as well as the housing industry, in particular.

Households accepted the market rates of consumer credit charged for building materials purchase as the cost of doing business. In fact, 40% of households surveyed were unable to remember the interest rate at which they took consumer credit. In comparison, moneylenders typically charge much higher rates – 10% per month in Brazil – while credit card companies charge stiff penalties when debt is carried from month to month, resulting in effective interest rates of as high as 140% per year.

In addition to credit for building materials, the Ashoka study reported that roughly half of households expressed a strong interest in specialized labor for construction. Families had hired qualified workers for roughly a quarter of work conducted in the past, wanted to reduce the amateur level of construction, and – because of increasing household incomes – were willing to pay for more professional help in the future. Prior to the research, Ashoka investigators thought that community members frequently helped each other with construction; e.g. barbecues to pour foundations. In fact, they found little evidence of such mutual self-help.

The Ashoka study concludes by recommending a pilot project in one favela in the greater Sao Paulo metropolitan area that joins consumer credit, discounts on building materials negotiated with local stores, and technical assistance to families in construction. This pilot project is currently in a start-up phase and briefly described in this issue of *Global Urban Development Magazine*.

The Cities Alliance/Municipality of Sao Paulo study conducted focus groups of building materials retailers and low-income households throughout the municipality of Sao Paulo. The locations of household focus groups spanned a wide range of low-income communities, including high-rise government-assisted low-income housing projects, government-assisted subdivisions of core units, shantytowns ("favelas"), and central city rental tenements ("corticos").

The focus groups confirmed progressive construction as the main method of housing investment for all of these low-income communities. The demand for HMF came not only from informal communities (favelas) but also from government projects – both high-rises and subdivisions of core units. Virtually all residents of these government projects wanted to remodel their apartments or core units, which had been delivered without internal or external finishing. Even 58% of the renters of central-city tenements owned by others wanted to improve the units in which they lived.

A number of factors, however, tended to deter housing consumer credit. Informal employment, the inability to qualify for formal credit, and lack of or credit history registered in a credit bureau were most mentioned. Largely as a result, most low-income households paid for most of their building materials purchases (70%) in cash, and used credit finance for most of the remainder.

Most low-income households used construction contractors much more than their own labor or family or friends, and also wanted credit in order to pay for specialized construction labor. The focus groups showed a strong interest in technical assistance in planning and design of construction.

The Cities Alliance/Municipality of Sao Paulo study also conducted extensive interviews with public and private financial institutions offering credit for building materials purchase and with building materials stores. Private banks typically targeted their credit towards their account holders or the clients of building materials stores with which they had formed business alliances. Public agencies and financial institutions targeted credit to low-income households earning up to three minimum salaries. Maximum amounts financed varied from US$2,000 to US$10,000. Interest rates for private-sector institutions ranged from 2% to 6.5% per month, and maximum terms from 12 to 48 months. Not surprisingly, households with no credit record tended to receive smaller loan amounts, higher interest rates, and shorter terms within these ranges.

Virtually all of the financial institutions that extended building materials credit required verification of household income and confirmation of no liens on the property registered in the local cadastre. Commercial banks often insisted that borrowers open an account in that institution, while other programs often demanded that a guarantor cosign the loan.

Profit levels varied dramatically among stores. The stores surveyed sold mostly to homeowners (40% to 60%), then to renters (10% to 30%), and finally to construction contractors (5% to 10%). Small stores purchased most materials very frequently – either weekly or every two weeks. These frequent purchases allowed small stores to save money by maintaining a small stock, but did not permit negotiating better prices through bulk discounts with suppliers. A key bottleneck in their business model is finance to buy larger quantities at one time from suppliers, and the capacity to negotiate better prices through bulk discounts.

These building materials stores lend based on knowledge of their client base and relationships of trust developed over time. Households pay largely in order to maintain their credit with the stores and place in their community. This logic closely parallels that of microfinance institutions. However, these stores' consumer credit lacked the rigorous methods of microfinance institutions, was highly fragmented, and suffered from lack of integration into other aspects of the store's business.

The Cities Alliance/Municipality of Sao Paulo study arrives at a number of key conclusions. Consumer credit finances approximately 20% of housing investment in Sao Paulo and is a huge business involving virtually all the major financial institutions of the country. However, enormous demand for small serial credits for housing remains unsatisfied. The study finds that housing microfinance could be greatly expanded to facilitate progressive housing if current consumer credit practices were revised to adapt to the needs of clients.

In particular, interest rates, terms, and the products and services must better suit customers. The extremely high interest rates charged to households without credit records in Brazil – 4% to 6.5% per month – are clearly unsustainable, and threaten to provoke a consumer debt crisis. Consumer credit should allow the finance of specialized construction labor rather than just building materials. While building materials retailers must offer or channel consumer credit to be competitive, they are not specialists in extending loans to low-income households and conduct this aspect of their business casually without integration into their larger business. Thus, there is a strong need for microfinance expertise, which could be acquired by forming business alliances.

The market for small housing loans goes far beyond construction materials for improvement of homeowner units in informal communities – i.e. prototypical housing microfinance. There is huge market demand in Brazil for small loans to finish, remodel, and improve government-assisted housing projects – both high-rise apartments and core-units subdivision – that essentially deliver an unfinished shell unit. Even most renters of central-city tenements ("corticos") have expressed interest in credit to fix up their units.

New strategic directions necessary to expand housing microfinance to a scale relevant to demand and need

The evidence examined in this paper suggests that current approaches to HMF will result in miniscule supply relative to market demand, and have little impact in meeting the low- income housing/urbanization challenge of the next two to three decades. HMF requires fundamentally new strategies to achieve massive scale:

Broaden the institutional platform for support of small credits for the low-income housing/upgrading process by using the building materials and supplying industry as the base and employ MFIs as intermediaries. Small home improvement loans have become a niche secondary product useful to many MFIs. In most countries, however, microfinance institutions lack the capacity and the interest to expand low-income housing credit to massive scale.

In contrast, homebuilders and building materials manufacturers and retailers must provide home credit for the bottom of the income pyramid, as a large portion of their sales come from this segment. Modern corporations such as CEMEX of Mexico provide a much broader, powerful, and more robust institutional platform for small home credit than do microfinance institutions, particularly in large countries. Although they recognize they must channel credit to grow their core business, building materials retailers and manufacturers frequently do not want to become lenders to poor families and communities.

In big emerging economies such as Mexico, Brazil, India, and Indonesia, some microfinance institutions may come to specialize as niche lenders for large distribution networks of suppliers of inputs to the progressive housing process or for large commercial banks. Various studies have suggested the use of MFIs as intermediaries for housing microfinance, particularly in Asia (e.g. Monitor Group, 2007). This option has many attractions. It builds on the comparative advantage of MFIs – their ability to keep in close relationship and work with low income households. In comparison, large building materials manufacturers and commercial banks face great difficulties in working directly in low-income communities.

Package HMF with other key inputs to the low-income housing value chain through business partnerships and new business models. The key to creating value and, thus, markets in affordable housing is not only to lower the costs of each step in the value chain but also, more importantly, to innovate and join products and services together into new business models that address larger segments of the problem (Ferguson, 2008). No one corporation or organization contains the range of products and services necessary to support progressive housing comprehensively. Hence, assembling appropriate packages requires business alliances among microfinance institutions, building materials retailers and manufacturers, banks, homebuilders, citizen-sector organizations, and government. Credit is only one of various important pieces of this puzzle.

In large markets dominated by modern building materials retailers and manufacturers, these large corporations are the most likely candidates to organize such business partnerships.

Expand beyond small home improvement loans to extend credit for the enormous variety of low/moderate income housing investment in emerging countries. "Housing microfinance" has come to be synonymous with small home improvement loans for building materials to expand a homeowner's unit. This is largely because microfinance institutions found that they could apply their existing loan methods and organizations to such loans with virtually no modification.

However, housing markets in emerging countries have evolved rapidly in the last decade. Low-income families earn more and a large new group of households – about 20% of the population of dynamic countries including Peru, Mexico, Brazil, India, and Indonesia – have graduated into the lower middle class. Small serial home loans can fill many of the new market niches created by this dynamism. For example, market assessments of Brazil show large demand for small credits to finish or expand government-assisted shell units – either in high-rises or core units in subdivisions – and for professional labor rather than just building materials. However, Brazilian banks and consumer-credit providers lack products useful for these needs.

The very small share of rental housing (less than 20% of housing stock) creates enormous problems for many low/moderate income families in many Latin America and Caribbean countries. Elsewhere – such as much of sub-Saharan Africa – most urban households rent, but no institutional financing or means of formal support exists for rental housing. Alan Gilbert's seminal study of rental housing in emerging markets has shown that the main rental supply comes from informal low-income communities. In this regard, small credit could be extended to build or remodel accessory spaces and units for rent.

A couple of US comparisons illustrate useful approaches to rental HMF. In the US, prudent lenders and mortgage insurers (e.g. FHA) apply the same favorable underwriting standards for owner-occupied single-family homes to owner-occupied apartment buildings of up to four units. Similarly, microfinance institutions, building materials retailers and manufacturers, banks, citizen-sector organizations and governments could support such small owner-occupied apartment buildings in low and moderate income communities.

South Shore Bank – the premiere community lender in the US – revitalized the south side of Chicago through financing local businesspeople to purchase and rehabilitate run-down rental buildings in this area. Community lending by MFIs, banks, and building materials retail credit programs should also include loans for multi-story rental buildings in low-income areas as well as prototypical housing microfinance – i.e. small home improvement loans to owner-occupants.

The governments of densely-populated dynamic East Asian cities (e.g. those of China) have little choice except to build shell condominium units in high-rises for low-income housing. Small credits could be used to build out the shell so that the unit becomes habitable.

In low-income South Asian countries – such as Pakistan – government has largely opted for the "sites and services" model for low-income housing projects. Typically, this means a plot of raw land in a distant subdivision with, at best, communal water and dirt roads without legal title to the property. The case of Saiban in Karachi (see the paper by Bruce Ferguson on urban land development in this issue of *Global Urban Development Magazine*) demonstrates the many ways that small home credit can improve this dismal reality when joined with other parts of the low-income housing value chain.

In many sub-Saharan African countries (e.g. Rwanda and Kenya), few urban low and moderate-income households individually own the land on which their houses sit, which is often communal tribal property or owned by others. In such contexts, some MFIs have begun to accept evidence of security of individual tenure (rather than ownership rights) – such as land leases – for underwriting small housing credits (Unitus/Lehman Brothers, 2007) . HMF can play an important role in financing low-income urban land development – the largest bottleneck to housing the poor (see Ferguson, 2008 in this issue of *Global Urban Development Magazine*; Freire, Ferguson, Cira, Lima, Kessides, and Motta, 2007).

Incorporate HMF into the core mission of MFIs (a recommendation of the Accion study presented by Messina, 2006), in particular, in smaller countries and markets where MFIs may well continue to play a lead role. In this regard, MFI networks must bring to the attention of individual MFIs the crucial importance of housing to their core mission of “giving people the tools they need to work their way out of poverty” (Accion’s stated mission). More frequently than in high-income nations, housing generates income through rental of spaces and accessory units, provision of the location for many micro- businesses, and as the main social security in old age in emerging countries with precarious or no pension systems. Most fundamental, homeownership is the main means used by families to build ***wealth***, which many studies show is the main route out of poverty and to upward mobility.

Raising the profile of housing credit in the MFI industry will require more technical know-how on this topic – that is, putting the “housing” back into “housing microfinance.” It will also involve formation of business alliances with other key players in the low-income housing industry including government, an institution that MFIs have long sought to avoid (as discussed directly below).

Channel government housing subsidies through second-tier housing banks experienced in working with developers and financial institutions in the form of small grants that complement housing microcredit. MFIs in Colombia, Nicaragua, and elsewhere have had trouble joining housing microcredit with government subsidies to help the poor. In essence, these MFIs fear – with good reason – that involving politicized government housing agencies will dilute the willingness to pay of households on microcredit. Historically, the MFI industry has grown out of a rejection of grants and subsidized credit for rural development and a recognition that only market-rate credit can sustainably finance micro-business (Robinson, 2001). Housing, however, is a “merit good” in which the public sector inevitably retains some responsibility. The colossal effort of the US government begun in 2008 to rescue this country’s housing and related finance sector is a vivid case in point.

In this regard, the SHF/Financiera Independencia partnership in Mexico demonstrates how to join effectively housing microcredit with small subsidies. One key is for government to delegate administrative and executive functions for housing subsidy programs to a second-tier housing finance institution with a good track record in extending market-rate credit and in working with developers, first-tier lenders, and others involved in housing supply.

Another approach is that of the Kuyasa fund of Cape Town, South Africa. This organization makes loans to families that have received a government housing subsidy that allows them to increase the size of their unit from an average of 23 square meters to 54 square meters (Unitus/Lehman Brothers, 2007).

Provide technical assistance to financial institutions for HMF along with appropriate funding mainly from domestic sources but also from international groups with experience across countries and regions. The GmbH survey of 25 Latin American MFIs found that appropriate funding is the main factor necessary to increase their housing lending. The paper in this issue of *Global Urban Development Magazine* by James Magowan details the characteristics of such "appropriate funding." More and better funding can certainly help in many instances.

With some frequency, however, declarations of "lack of appropriate funding" indicate deficits in the know-how, information systems, and business alliances necessary to engage in low-income home lending. Packages of funding and technical assistance from international sources with experience in a range of countries have an important role to play in supporting HMF. Such international support can disseminate important innovations. As capacity develops, this funding and TA best comes mainly from local sources.

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[i] Interview with Jesus Ferreyra, the senior manager of MiBanco most responsible for developing the MiCasa product, on May 22, 2007.

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CAPITAL-MARKET FUNDING OF AFFORDABLE HOUSING FINANCE IN EMERGING COUNTRIES: THE BUSINESS CASE

James Magowan

Two-thirds of the world's emerging market population subsist with inadequate housing. India alone has an unmet housing need of 20 million units (Trevedie, 2004). This unmet demand is likely to increase as urban populations continue to grow rapidly, particularly in South Asia and Africa.

Families are moving to cities with scant resources but with an entrepreneurial spirit and a strong desire for the habitat essential for a modern life – shelter, secure tenure to property, water, drainage, sanitation, and electricity. A key challenge, then, is to connect capital markets with low-income, rapidly-urbanizing populations to improve their habitat and living standards. These families need the basic financial products and services that most households in developed markets enjoy: short-term and long-term savings vehicles, credit instruments, insurance products, and property rights. In much of the developing world, the penetration of financial services to the low and moderate-income majority remains remarkably limited. Mexico, Colombia, and Honduras have a total population of 160 million people and a share of loans plus deposits to gross domestic product (GDP) of less than 30% (ProCredit, 2007). This compares to the over-leveraged Britons with personal debt to GDP of over 100% (Grant Thornton, 2008). Mortgage debt to GDP is only 3% in Brazil, 5% in India, 10% in Mexico, against 72% in the United States (Sources: ProCredit, Boston Consulting, World Bank, Assocham, 2007*).*

Some emerging countries have made substantial progress in serving the middle class with housing finance. Founded in 1977, Housing Development Finance Corporation (HDFC), an Indian bank, was originally built on the provision of mortgages for the middle class, well before adequate property rights were available to secure for such loans. HDFC has diversified into a full-service bank with a market capitalization of over US$8 billion, the third largest in India. In Mexico, the government chartered wholesale financier Sociedad Hypotecaria Federal ("SHF") has also made serious inroads into delivering products for the middle-class in partnership with an industry of mortgage banks (housing Sofoles) that emerged after the Tequila Crisis in 1994.

Despite these public and private examples of success, the vast majority of the 4 billion persons that constitute the bottom two-thirds of the income pyramid spend more than US $400 billion annually on housing (WRI, 2007). So, given the demand, why isn't the private sector more actively involved in supplying finance to the 440 million households with incomes of $5 to $8/day (Warnholz, 2008)?

The reasons are many. However, there are two main bottlenecks: (1) the lack of viable institutional partners capable of serving this market; and (2) long-term funding in local currency. Supplying these two missing elements is a classic chicken/egg problem. Without access to the funding, the institutions cannot develop; but the money will not flow to the institutions until they have adequate capacity. Successful retail housing finance delivery requires a joint application of institutional capacity-building and funding, partly through capital-markets development. The following discusses each of these key bottlenecks and the process for overcoming them.

Institutional partners

Who currently addresses this market?

At the frontlines of delivering credit to this market are microfinance institutions (MFIs) – regulated and unregulated – non-profit foundations, credit unions, cooperatives, finance companies, banks, and home improvement retailers. Microfinance institutions have an estimated total loan portfolio of US$25 billion (Deutsche Bank, 2007), with roughly 20% in housing. Little data is publicly available on home improvement retailers' portfolios of consumer credit for building materials. However, some recent studies in Brazil (Cities Alliance, 2007; Ashoka, 2007) suggest that these retailers finance approximately 20% of housing investment in that country alone – approximately US $5 billion per year. Since building materials retailers extend consumer credit in many dynamic emerging markets (e.g. middle-income Latin American countries, India, Indonesia) to remain competitive, the total volume of affordable home lending through this mechanism most likely far exceeds others.

MFIs

Robinson has estimated that only 200 MFIs were commercially viable in 2001 worldwide. Perhaps 100 have sufficient scale, operations and experience to address housing finance now. A few MFIs are, indeed, expanding their housing finance operations rapidly. Housing portfolios (home improvement and mortgage lending) at seven MFIs in the Accion network are growing at around 50% annually (ACCION, 2007).

However, MFIs have for the most part focused on higher-margin, short-term working capital lending , more than housing. Many MFIs have introduced a home improvement product over the years, recognizing that the home is also the workplace. Some have also ventured into longer-term housing loans for new construction and purchase of new units.

Many MFIs view longer-term housing loans, in particular, as a defensive product, aware that commercial banks will otherwise poach their best customers in highly competitive markets. MFIs that seek to offer a full suite of financial products and services to their clients believe that housing is an essential credit product. Properly managed, housing's long term asset/liability financial structure should increase stability, enhance overall revenues, and reduce risk. To understand this, MFIs must fully study the costs and benefits of housing finance from a complete lifetime customer value perspective.

Increasingly, larger MFIs have converted into regulated, deposit-taking banks – a process that requires improving their governance, transparency, and operational capabilities – the preconditions to MFI success in housing finance. Uniquely suited to address informal low-income workers, large, regulated MFIs are becoming excellent potential channel for housing finance.

Cooperatives

Cooperatives have strengths similar to those of MFIs, with the added benefit that they have achieved substantial scale in many markets. They have also been able to mobilize low-cost savings and are typically regulated. Housing is very important to their membership. In certain markets such as Peru and Bolivia, cooperatives are among the strongest financial institutions in the market. In Mexico, they are large, but not as operationally efficient. Due to the non-profit associative structure of cooperatives, risk management and governance quality varies greatly.

Credit Unions

Credit unions have traditionally served salaried workers with slightly higher incomes than MFIs. They offer many of the benefits of MFIs and, as cooperatives, have the ability to take deposits. While credit unions are usually regulated by their central banks, their nonprofit ownership status can create challenges in managing a housing finance product. For example, in attempting to pursue recovery of a loss in the event of a default on a housing loan, the credit union might face legal obstacles as the recipients of these loans are also their members/shareholders. When credit unions have a high exposure to one cyclical industry or company, their reliance on salaried workers can also increase credit risk.

Consumer Finance Companies

Some large-scale consumer finance companies have entered the home improvement finance marketplace in large economies such as Brazil, Mexico, India, and Indonesia. Financiera Independencia in Mexico recently expanded its offerings to include a housing microfinance product that joins low-cost funding and a subsidy to households from SHF (see the paper by Bruce Ferguson, "Housing Microfinance: Is the Glass Half-Full or Half-Empty?", in this issue of *Global Urban Development Magazine* for details on this case). The results have been an astonishing growth in clients.

Consumer finance companies spend much less time evaluating the creditworthiness of their borrowers, and generally have higher arrears rates than MFIs. Depending on the strength of their underwriting, they could face substantial trouble in a recession. Although consumer finance companies offer short-term home improvement loans, they usually avoid longer-term, larger housing loans for other purposes.

Home Supply Retailers and Home Builders

In dynamic economies with limited sources of institutional housing finance, large homebuilders frequently supply purchasers with home credit in some form. In Brazil, large homebuilders often require that purchasers commit around half the purchase price in advance of building and accept the remaining half in the form of a few installments over a period of time after occupancy.

Homebuilding materials manufacturers and retailers have also realized that they are leaving large segments of the population without the credit necessary to purchase their products. In Peru, Maestro Home Center, the country's largest home improvement retailer, has partnered with a bank to issue credit cards to the informal market. Corona, a large home retailer in Colombia, has an internally-managed home improvement credit product that is marketed through a network of low-income, neighborhood female sales representatives (see the case study by Gutierrez in this issue of *Global Urban Development Magazine* for details). The company has plans to expand this popular product from a pilot phase.

Long-term funding in local currency

Competitive interest rates and longer terms in local currency are essential to funding housing credit.

Structuring capital markets issues for housing finance in emerging economies

Achieving such competitive funding on capital-market debt for housing occurs through structuring issues properly. Capital-market debt issues typically have "senior" tranches that offer priority in payment in return for a lower investor interest rate. In turn, "junior" tranches subordinate payment to the senior tranches in exchange for higher investor returns. The greater security of senior tranches (called the level of subordination) and the credit rating of the institutions and the countries where lending occurs (called the "sovereign risk", which generally is also the ceiling for the nations' corporations) are key factors in attaining "investment grade" ratings from credit rating agencies (e.g. Standard & Poor's, Fitch etc.). Due to the emerging nature of investment, institutional investors generally have required AA or AAA ratings for senior tranches. Higher-risk junior tranches are typically held by development finance institutions (DFIs) such as the private-sector arms of multilateral donors, non-profit foundations, or other socially minded investors.

From the perspective of capital markets, long-term transactions in countries with marginal credit ratings become very expensive, and require very high levels of expensive subordination to achieve investment grade senior tranches of a transaction. Assembling a portfolio of housing loans from various MFIs, credit unions, and home retailers in emerging countries with a wide range of sovereign risks might produce an overall credit rating of BB – significantly short of investment grade. To achieve an AA rating on the most senior tranche might require 40 to 60% of the transaction structured with subordinate debt. As the subordinate debt carries much higher pay rates, this can quickly escalate the cost of overall blended cost of a structured debt transaction.

A central issue in structuring issues is to remind rating agencies that defaults have been rare in microfinance, and that commercial loans (most housing transactions would be structured as secured commercial loans to international financial institutions) in emerging markets have quite high recovery rates. Fortunately, considerable empirical evidence exists to back up this conclusion. A 27 year study conducted by Citibank, showed an average loss in the event of default ("LIED") of only 31.8%. In other words, investors should expect to recover 68.2% of the default amount for commercial and industrial loans (Citibank, 1998). There is far less data on losses and recoveries for low income borrowers in emerging markets. However, the risks of home lending in emerging economies display some considerable differences with those in high-income countries that require explanation to investors, rating agencies, and others involved in the investment process:

Risk

Secured versus unsecured lending

In high-income countries with solid legal systems, loans secured by mortgages carry much lower risk than those without. Correspondingly, the ratio of the loan amount to the appraised value of the property holds crucial importance for mortgage portfolios in advanced economies.

For many reasons, securing housing loans with mortgages increases security and reduces risk much less in emerging countries. Homeownership in emerging countries is much more crucial to families' economic and social security then in affluent countries. A survey conducted by the Inter-American Development Bank in 2007 indicated that the two most important needs for emerging market consumers were housing construction finance (47%) and health/life insurance (47%).

The importance of housing shows up in the housing portfolio statistics of microfinance institutions. A survey conducted by ACCION International (2007) shows that delinquency rates at seven MFIs in Latin America and the Caribbean ranged from 0.5% and 2%, consistently better than portfolios of working capital loans at the same institutions. At BancoSol in Bolivia, the portfolio at risk ("PAR") greater than 30 days, in effect those paying more than 30 days late, for housing loans that are secured or unsecured both average less than 1%. Compare this to a PAR greater than 90 days of more than 6% in the United States today!

Most homeowners in emerging markets lack full legal title to their homes, but still have security of tenure. As Hernando de Soto likes to say, the dogs know the boundaries between properties in most emerging markets. With the exception of the Newly Independent States and Eastern European countries – which have well-established real property records – there are only a few emerging countries (such as Peru and El Salvador) where governments have instituted reliable, low-cost property registries that can conduct a title search or record a mortgage quickly. In federal countries such as Brazil and Mexico, state governments make real property laws, operate real property registries, and often employ the police and other agents involved in executing foreclosures and other processes related to real property. Not surprisingly, the performance and the accuracy of real property registries vary tremendously among states. When loans do go into foreclosure, the experience is usually slow and expensive; a three-year foreclosure period is a reasonable estimate for a majority of emerging markets.

Once the property is finally foreclosed, the financial institution may have great difficulty selling the home to recoup their cost because of thin real estate markets. Many households buy and occupy a home for life, and then pass the property to their heirs. Thus, resale markets are spotty.

In summary, foreclosing on mortgages is so difficult and costly that it is impractical in many contexts. As the portfolio qualities of secured property loans are so high, experiences with delinquencies are rare. Where there is a willingness to pay, the vast majority of loan officers will make every effort to re-negotiate the loan terms. As a result, microfinance institutions and other low/moderate income home lenders focus great effort and attention on underwriting informal borrowers so that they can avoid foreclosure in the first place.

Non-mortgage forms of security and lending practices hold more importance to reducing risk. Some MFIs have been able to reduce risk by using very conservative cash flow-based underwriting techniques. Where property rights are difficult to manage, MFIs may require co-signers, group or solidarity guarantees, and/or assignments of non-fixed, personal assets to underwrite loans.

Credit Underwriting

Especially in low-income markets, prudent lenders extend credit based almost exclusively on capacity to pay. Non-salaried workers are often a safer bet than salaried workers – the reverse of high-income countries, where lenders prefer salaried workers over the self-employed. Independent entrepreneurs do not rely on employers for their livelihoods, and cannot be fired. They offer goods and services less tied to the global economy and may be more resistant to the frequent fluctuations of emerging economies.

Some lenders limit principal and interest on debt service payments to 50% of self- or informally-employed borrowers' free cash flow after deducting all debt service and living costs. Because there usually aren't tax returns or pay stubs to validate, MFIs must go to elaborate steps to create cash-flow statements and balance sheets for their micro- and small-scale borrowers. Mortgages lenders, banks and credit unions in the same markets may use the more familiar maximum ratio of 30% of housing debt to after tax income for underwriting home loans to salaried workers. Loan-to-value ratios of up to 80% are common.

Political risk

In addition to the conventional risks of lending, political risk is always a reality with housing. After the credit crisis in Colombia in 2000, the government capped real interest rates at 11% for low-income borrowers and 13% for all other secured home loans of greater than five years' duration. These interest-rate caps have greatly restricted the use of government housing subsidies because they must be joined with home credit, which interest rate caps has made unavailable to most low-income households, in order to complete the amount necessary for the housing improvement or purchase. In Nicaragua, the government has recently intervened in state-run microfinance operations. Political risk insurance from entities such as the Overseas Private Investment Corporation (OPIC) may be warranted in selected emerging markets. Efforts should be made to lift interest-rates caps in order to attract more capital sufficient to develop large-scale efficient operations and, eventually, lower interest rates.

Currency Risk

Any properly structured global housing transaction should facilitate lending in local currency, or the expected final borrower's primary income currency (some emerging countries operate mainly with or have officially converted to the US dollar). Investors, on the other hand, don't usually want to take the currency risk and seek to hedge this hazard. Until recently, private investors have been unable to obtain hedging solutions for some currencies (e.g. Nicaraguan Cordobas) for periods greater than three years. Long-term local currency hedging issues can often be resolved by new currency exchanges offered by the World Bank and TCX, the currency exchange. TCX absorbs the currency risk by swapping hard currency (Euro/Dollar/Yen) positions with local positions for up to 15 year periods on a floating or fixed basis.

Return

Real interest rates on funding to intermediary financial institutions (which are called "wholesale" interest rates) must be positive to attract investors, both local and international. The expectations for return of international investors vary depending upon institution – foundation, donor, socially-motivated investor, and others. Depending on the transaction, institutional investors will invest in various pieces or "tranches" of transaction. There is generally one or more junior or subordinate tranches in a structured deal. Given the current risk environment, conservative institutional investors will typically focus on senior, highly-rated AAA and AA tranches at small yields over the 10-year LIBOR (the London Interbank Offered Rate is the rate at which banks lend to one another) swap rates. The 10-year LIBOR swap rate converts a local floating rate to a fixed 10 year loan, usually at a small premium over the US dollar or Euro treasury bond rate. DFIs and non-profit foundations have been willing to invest in this area at concessionary rates to help develop long-term capital markets and to support housing finance for low and moderate- income borrowers. The DFIs are also willing to invest in the technical capacity of the local financial institutions (called here "intermediary financial institutions", (IFIs)) that lend these funds to the final household borrower.

The local intermediary financial institutions must also earn a margin high enough to cover their costs, earn a profit, and capitalize their organization so that they can grow. MFIs and others that extend credit to low-income borrowers typically must charge real rates (that is, the nominal rate minus the inflation rate) of 8% to 15% per annum for long-term mortgage finance (known as "retail" interest rates) to build or purchase a new home in order to be profitable.

In turn, low and moderate-income households typically can afford to borrow smaller amounts in the form of unsecured credit at higher rates for key housing improvements. In Latin America, households accept paying 3%-5% per month as the cost of doing business for credit for the purchase of building materials to replace a dirt floor with tile or cement, or to add a room. While these rates seem high, they reflect the small loan balances ($500 - $5000) and high underwriting and servicing costs as well as the lack of competition. Competition among lenders joined with stable macro- financial conditions does eventually push rates down. For example, these factors have forced rates for small home improvement credit down from well over 60% per annum to around 30% to 40% per annum in Peru and Colombia over the last five years.

In practice, balancing risk and return to arrive at appropriate interest rates for funding affordable housing finance is an art more than a science. Windows of opportunity open and close with changes in global and local financial conditions. In early October 2008 (as of the writing of this paper), the rate at which banks lent to each other reached over 4.5% above the corresponding US Treasury rate because of the credit crunch, making capital-markets funding of affordable housing in emerging countries unfeasible. This compares to a premium of 0.50% in early 2007 – a level that would permit capital to flow locally and to emerging markets.

Longer terms

The term of loans is a crucial factor in balancing risk and return. Currently, most housing finance institutions in emerging countries depend upon very short-term liabilities – such as demand deposits – to fund housing loans with substantially longer terms. This mismatch creates substantial interest-rate risk for the institution. Banks face four types of interest rate risk: *basis risk* arises from lending and borrowing based on different reference sources (i.e. prime rate vs. libor rates in the US); *yield curve risk* comes from borrowing short and lending long; *repricing risk* occurs with mismatches between the assets and liabilities (i.e. borrowing at a fixed rate and lending at a variable rate); and *option risk* arises when loans can be pre-paid or extended beyond expected maturities.

Terms for housing finance funds must be long, but how long?

Of course, increasing the term of housing loans reduces monthly payments and increases affordability. Extending the term of a loan with a 15% interest rate from five to 10 years reduces the monthly payment by 32%, and yet extending from 10 to 15 years only reduces the payment by an additional 13%. In a high interest-rate environment, 10 years seems to be an optimal risk/benefit point for a loan term to household borrowers.

However, families as well as financial institutions often resist increasing the term of housing credit. Low and moderate income households in emerging countries live in a much more volatile economic environment, where incomes and employment fluctuate widely over periods typical of mortgage finance in high-income countries (20 to 40 years). As a result, families avoid taking long-term credit that would put their home at risk and often pay off housing loans as soon as they can, frequently in as little as two years for smaller home improvement loans. To reduce risk, low/moderate home lenders sometimes require participation in a prior savings program and a lengthy payment history before they grant longer-term loans.

The terms offered by the Peruvian commercial microfinance bank MiBanco – the premiere affordable housing lender of Latin America (see Ferguson's paper "Housing Microfinance: Is the Glass Half Full or Half Empty?" in this issue of in this issue of *Global Urban Development Magazine* for more details) illustrate how these factors play out in practice. MiBanco's MiCasa program offers home improvement loans of up to $10,000 for up to five years without a mortgage guarantee. The requirements include an actual remodeling or home improvement plan, income verification, and a valid title (but not necessarily official recordation in real property registries). Payments are made on weekly, biweekly or monthly basis depending on underwriting criteria. Effective interest rates range from 33% to 55% per annum.

MiBanco's Mihipoteca product offers a local currency loan secured by a mortgage of up to 15 years at an effective annual rate as low at 17.17% on amounts of $10,000 to $96,000. For independent workers, this bank requires multi-risk insurance, mortgage of a valid registered title, a business or association license, and at least six months of operating history.

Thus, setting an appropriate term for funding is an alchemical process. In the current context, terms of 10 years for the wholesale funding extended to local intermediary financial institutions for affordable home finance appear reasonable. On the retail side, terms of 10 to 25 years for mortgage finance to purchase or construct a new home often suit moderate and middle-income households. The term of small home-improvement credits to low-income households usually ranges from one to five years. Frequently, lenders will set the term of small home improvement credits within this range at the shortest period that makes the monthly payment affordable to the household.

Process

Funding

Long-term local currency funds are essential to build an affordable housing finance market. Up until now, such funding has been provided mainly through DFIs lending directly to local institutions, typically through second-tier housing liquidity facilities (see below). But there is a case to make for private-sector actors who can listen to the market and design products quickly and efficiently, and also reach a broader number of smaller first-tier institutions as well.

Privately managed global, regional and national wholesale financial vehicles can do this job. At the start, global structures may make the most sense as they offer investors the chance to diverse risk across countries. Private global transactions can help local intermediary financial institutions reach the minimum efficient scale for affordable housing lending – at least $100 million.

Private sector issuers of debt can partner with IFIs to jump start the market. For example, the Alsis Funds has launched a fund to acquire mortgage assets in Latin America with funding from U.S. Overseas Private Investment Coporation (OPIC), International Finance Corporation (IFC), and private investors.

Standardization

Regardless of the source of funding, establishment of norms for local affordable home lending (call “loan covenants”) can help develop the market (standardization of underwriting and servicing procedures, lower rates for mortgage collateral).

Until the recent credit crisis, microfinance investment vehicles (MIVs) have delivered several billion dollars in funding over the past four years (but very little of it earmarked for housing). While the MIVs have helped bring sophisticated debt instruments to emerging-market borrowers, the MIVs have generally refrained from standardizing underwriting and documentation. However, such underwriting covenants not only help to ensure that the transaction is safe for investors, but also stimulate local markets to develop.

Covenants by the funding source appear particularly important for affordable home lending. For example, SHF’s conditions for lending have, in effect, regulated the successful operation of the housing Sofoles in Mexico.

If local investors know that all of the IFIs within a market must adhere to a common set of standards in underwriting and documentation, they should be more likely to have confidence in purchasing those assets at a future date.

Second-tier Liquidity Facility and Private-Sector Investment

One way to provide long-term competitive funding in local currency is to create a local second-tier housing liquidity facility. This facility typically takes equity capital from central government and, sometimes, multi-lateral donors. These liquidity facilities then raise debt from multilateral donors as well as the private market – first domestic and then international – and on-lend these funds to local IFIs. In turn, these IFIs extend home credit to the final household borrower.

Donors and governments have joined to create such second-tier housing liquidity facilities in many of the larger, more-developed emerging economies, including India, Malaysia, Mexico, Peru, and Colombia.

Such second-tier housing liquidity facilities have definite advantages and disadvantages. On the positive side, they help to get markets moving by providing liquidity. If home lenders know they have a well capitalized buyer in place, they may be more likely to lend to homeowners in the first place. On the other hand, the financial debacle in 2008 of Freddie Mac and Fannie Mae – the enormous second-tier housing finance institutions of the US (jointly owning or guaranteeing 70% of the $12 trillion in home mortgages outstanding in the US) shows that mistakes in structure and regulating second-tier liquidity facilities can have dire consequences for the market.

Alternatively, the private sector can invest in first-tier home lenders. Successful private-sector investment in middle-income emerging market housing finance include SA Home Loans in South Africa, Su Casita in Mexico and HDFC in India. SA Home Loans was formed as a partnership between management, Standard Bank, JP Morgan and IFC. Su Casita received $14 million in initial capital from IFC and the US homebuilder, Pulte Homes, in 1994. Su Casita built up a $5 billion servicing business and was sold in 2008 to a Spanish Bank. HDFC is now the third largest bank in India. These successes serve as examples of the market potential in responding to the home ownership desires of the middle class in emerging countries.

Private and Public Investment in Technical Capacity

Technical assistance funding by the public sector and non-governmental organizations (NGOs) can enhance and speed this process of private investment Such technical assistance funding can help build risk, market, and treasury capacities at MFIs, finance companies, and home improvement retailers that provide affordable housing finance.

The technical assistance should cover areas such as: (i) conducting and monitoring market information; (ii) developing mortgage, home improvement, and other home related loan products; (iii) processing and tracking forms; (iv) mortgage lending operating manuals (operating procedures and lending documents), including: regulatory, title, security instruments; accessing subsidies for final beneficiaries, developing mortgage guarantee programs; selection of service providers (i.e. insurance, appraisers, inspectors, bankruptcy repossession); creating underwriting standards; compliance with building standards and codes; (v) sample loan files and tracking reports, (vi) risk management, vii) servicing, and (viii) refinancing, work-outs, and repossession. A high level of standardization can be achieved through an action plan to ensure that each IFI puts in place the procedures and controls to ensure that they reach the required levels.

This no or low-cost technical assistance "equity" should be invested where financial incentives are greatest or encourage development of smaller markets. Examples of technical assistance funds for housing include funds from GTZ (German Agency for Technical Cooperation) in Africa, SIDA (Swedish International Development Cooperation Agency) in Central America (see article by Irene Vance "Putting the 'Housing' Back into Housing Finance for the Poor: The Case of Guatemala" in this issue of in this issue of *Global Urban Development Magazine*), and the IFC's Housing Toolkit for Africa.

Conclusion

With a major increase in appropriate long-term funding, investments in technical capacity and second-tier liquidity facilities, private capital should have a substantial role to play in developing the markets and institutions to serve the bottom two-thirds of the income pyramid with housing finance services across the emerging world.

Experience will be certainly different by country and region. The strongest prospects for immediate growth may not necessarily come from commercial banks alone, despite their financial and management strengths. Business alliances among a range of financial institutions (commercial banks, MFIs, housing cooperatives, and credit unions) and home suppliers (homebuilders, land developers, building materials manufacturers, and retailers) are essential to reach these markets at massive scale.

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FINANCE FOR LOW-INCOME HOUSING AND COMMUNITY DEVELOPMENT

Diana Mitlin

I. INTRODUCTION

In most urban areas in high-income nations and many middle-income nations, good quality, legal housing is expensive. Most of it would not have been built without mortgage finance; middle-income households, and even most upper-income groups, need mortgages in order to buy it, or long-term finance in order to build it. In most cities in Africa, Asia and Latin America, low-income households cannot afford legal housing or good quality housing. They either rent (usually in poor quality overcrowded dwellings) or buy, or build in illegal settlements. They cannot get conventional housing finance because their homes are in illegal settlements and they lack the income or formal documentation that housing finance agencies require.

However, there has been much innovation in finance to support housing, infrastructure and community development for low-income groups over the last 15 years.[1] Much of this works in informal settlements, supporting negotiations for land tenure security, house construction and improvements, and often improved provision for water and sanitation. Most schemes combine savings, loans and subsidies. During these 15 years:

- State programmes have become less concerned with direct provision of housing and more interested in working with finance to enable greater choice for beneficiaries.
- Microfinance for housing became a significant part of the microfinance portfolio of lending opportunities, although mostly for house improvements and extension.
- Financial deregulation has increased the number of agencies interested in providing mortgage finance in a number of countries, and these are available to a larger section of income groups.
- Innovative approaches using savings and loans to transform low-income neighbourhoods have demonstrated impact at scale.

II. THE THREE KEY SOURCES OF HOUSING FINANCE

The role of savings

It is often assumed that low-income households cannot save for housing, as all their income is needed for consumption – or if they can save, it is only sufficient for community-managed emergency funds or small loans for livelihoods. But many case studies show the importance of savings for shelter investment by low-income groups. Low-income individuals often start savings to provide a fund they can draw on to help cope with emergencies or illness – and this develops into savings for housing too. This is especially so if they have a local savings scheme to which they can contribute, as in the community-managed savings groups that are the foundation of so many federations of slum and shack dwellers.[2] Savings may support housing improvements outside of any housing programme, as shown by a study in two low-income settlements in Tanzania.[3] Renters and would-be owner-occupiers also helped to finance construction with advance rent payments to their landlords (who owned the structures), once settlements became more established.

In Pakistan, household savings have financed the development of infrastructure in over 300 predominantly low-income settlements. Here, financing takes place within a technical support programme from the Pakistan NGO, the Orangi Pilot Project–Research and Training Institute. This is an example of a financial model that uses domestic savings and has a capacity to go to scale once residents are convinced of its value.[4] One key to its success is keeping down unit costs, so what is provided matches what low-income households can afford. Case studies from South Africa and Namibia also show the benefits of savings programmes – some residents choose to finance improvements through savings rather than taking up loans that they may be entitled to. In South Africa, the Kuyasa Fund offers small loans (often placed within the rubric of microfinance) for shelter improvements. Savings is required prior to loan release and 65 per cent of members only use their programme for savings.[5] In Namibia, many households within the Shack Dwellers Federation of Namibia prefer to use savings rather than loans to finance the extension of infrastructure from communal to on-plot facilities (for instance, from community to individual taps and toilets). This avoids the risk of not being able to meet loan repayments, for those with low and irregular incomes.[6] In this instance, and also in Malawi, savings is more than simply a means of financing shelter improvements; as in the case of the affiliates of Shack/Slum Dwellers International, community-based savings groups are the core organizing "glue", which help individuals save and which hold local organizations together, enabling them to build the trust and confidence needed to identify collective priorities and implement development projects together.[7] Savings is widely acknowledged to offer benefits in other cases, as in the examples of the Kuyasa Fund[8] and IVDP,[9] although the orientation tends to be on the financial rather than the development process, and hence the benefits are less comprehensive.

In some countries, it is difficult for low-income individuals and groups to get a bank account. They have to form their own savings institutions because no local bank or other institution will support them. In many low-income areas, there are no banks; and where there are, they often only provide accounts to those with formal employment or proof of income, and relatively high incomes – and they often have high charges. Not having a bank account implies not only difficulties in saving, but also many other problems and additional costs in making payments (for instance, to utilities or service providers) and in sending and receiving money.[10]

Microfinance for house improvements

A growing number of microfinance agencies offer small loans for housing improvements. They usually offer finance only to individual households living on land sites with reasonably secure tenure, and they enable dwelling investment that usually entails adding a room, or an improved roof and/or floor, toilets and/or bathrooms. Shelter microfinance emulates many aspects of enterprise-orientated microfinance and is often embedded within the same agencies. In *KixiCrédito* in Angola, housing finance is offered to those households that have been successful in enterprise borrowing; a second stage is the extension of shelter lending to other specific groups under alternative terms and conditions.[11] The Kuyasa Fund in South Africa offers small loans for housing improvements and expansion; these help low-income households that have already benefited from state intervention through a housing capital subsidy programme that provides a plot with legal tenure, services and an initial dwelling. In both cases, the rapid development of loan programmes illustrates the scale of demand for borrowing for housing within low-income settlements. In the Philippines, there is also this combination of state housing programme and loans for housing improvements. The government programme, Development of Poor Urban Community Sector Project, supports local authorities for site development and improvement with housing loan provision along with microenterprise finance.[12] A comparable model has been implemented in various Central American countries. Here, local authorities coordinate the upgrading of low-income neighbourhoods and a range of local institutions offer loans to households to improve their homes. In some cases these can be combined with state subsidies. In every case these loans blend with family savings and self-help efforts, and this blending has demonstrated its effectiveness in many places, as long as the unit costs of housing and infrastructure construction or improvement are not too high.[13]

Group lending for housing

A third source of finance for housing is the collective process of group lending. This is generally for more than just housing and includes loans that fund investments in land and infrastructure. In Namibia, the Shack Dwellers Federation and its support NGO, the Namibia Housing Action Group, have developed a model that includes regulatory reform, land purchase from local authorities, the extension of infrastructure provision and dwelling construction. This model is affordable to some of the lowest-income citizens as the housing component of the loan does not have to take place immediately, and land and service costs can be paid off first.[14] For the Malawi Federation, a sister to the Namibian Federation, group loans were taken to finance the construction of identical dwelling units for the development of housing on 222 plots in Lilongwe. The political impact of these units has been considerable; the national government was sufficiently impressed by the speed and competence of federation members in their construction that it provided the federation with more than 3,000 housing plots. In most of Lilongwe, where there is no provision for sewers, the loan amounts have also been sufficient to pay for the cost of skyloos (elevated pit latrines).

In the Philippines, the Community Mortgage Programme is an example of state support for collective loans. Here, credit for purchasing land is available to groups of low-income households facing eviction from land on which they are illegally settled.[15] In Thailand, an innovative state-financed programme (the Community Organization Development Institute) has put in place community networks able to manage many aspects of the development process at a local and city level, as well as providing loans available to communities for supporting upgrading or new house construction. Here, the move in the level of intervention from neighbourhood to city level has been important in enabling finance to be used to transform options for some of the lowest-income and most disadvantaged citizens, and for supporting community organizations and local governments to work collectively to address diverse needs and interests across the city.[16] Citywide networks of community organizations work with local authorities in participatory planning and allocate both subsidy and loan finance. This enables the planning process both to prioritize the settlements most in need of upgrading and to consider how finance can help support local environmental improvements for the benefit of all.[17]

III. THE RANGE OF DIFFERENT AGENCIES DRIVING CHANGE

These three different financing strategies for housing – savings, microfinance and group lending – reflect the differences in local circumstances and in the agencies that are engaged with this process. In some cases, the key agent is the people, managing as best they can – as in the case from Tanzania.[18] In Pakistan, for the investments in sanitation and drainage made by communities, the key agent is also the people, but in this case supported by an NGO, the Orangi Pilot Project–Research and Training Institute. This NGO provides technical assistance, catalyzing sanitation investments by showing how the unit cost of good quality provision can be brought down to one low-income communities can afford.[19] In the case studies from South Africa and Angola, the key agencies are microfinance providers, which in both cases emerged from the work of conventional urban development NGOs, Development Action Group[20] and Development Workshop.[21] This highlights a tension for NGOs seeking to provide new shelter options for low-income households, because the organizational demands for providing financial services are very different from those for advocacy. In these cases, in Angola and South Africa, two distinct organizations have developed. These experiences suggest that it is difficult to manage a microfinance agency and an advocacy-oriented NGO within the same organization. Over time, both organizations have divided into two although, in both cases, the newly created microfinance agencies collaborate closely with their "parent".

The success of collective loans requires strong local organizations. In the cases noted above, in Malawi, Namibia and the Philippines (Community Mortgage Programme), professional support agencies provide advice on the technical aspects of development and offer other kinds of assistance. In part, this is required because these housing development programmes have to work with local authorities, which means working with all their building, land use and infrastructure regulations. In Malawi and Namibia, the local grassroots organizations are networked through federations that enable them to visit and learn from each other. The formation of federations also helps pressure the government to agree to regulatory reforms that reduce development costs (for instance, smaller plot sizes and less expensive infrastructure requirements). Politicians are reluctant to be seen to ignore the demands of mass movements; and may believe that regulatory reforms are a relatively low-cost route to respond to citizen demands There is little evidence of the commercial sector in these case studies, although in the broader field of microfinance, there is considerable interest shown by formal financial institutions in some Asian and Latin American nations.[22] The growth in experience in microfinance for housing has shown the commercial sector that there is a viable market at least in some nations and cities, which can be served by financial institutions or through their collaboration with microfinance agencies. This is important in supporting many lower-income households with relatively secure tenure of their housing plot to improve their homes, but it does not address the needs of the lowest-income groups who are landless.

IV. THE ROLE OF THE STATE

The state is rarely the driving force behind shelter finance initiatives, but it still has a powerful influence on whether low-income groups can get good quality housing. First, it influences land markets and the possibilities for land tenure regularization in informal settlements. Land regularization and the extension of infrastructure and services to what were previously illegal settlements may provide a very good context for providing loans for upgrading.[23] So too may the allocation of land sites to community organizations formed by the urban poor, as highlighted in the case in Malawi mentioned above. Obviously, this process (and any state-managed resettlement), influences the location of low-income settlements and the degree of spatial and/or social inclusion for such settlements. Second, the state's many rules and regulations regarding land use, infrastructure and buildings, and the ways these are applied, influence housing and land prices and availability, and thus whether lower-income groups can get or build legal housing. The extent and application of regulatory systems influences the scale of illegality associated with shelter provision in informal settlements. In Namibia, far more low-income households were able to take part in official legal housing developments when the Slum Dwellers Federation negotiated lower and more flexible building and infrastructure standards, In Malawi, the low-cost housing required the Malawi Federation to negotiate to get approval for the use of traditional materials.

Third, state programmes for services or for social protection may reduce costs or increase incomes,[24] and so increase the amount that low-income households can spend on or save for housing. Any shelter finance project that addresses tenure and service needs has to come to an accommodation with the state, even if microfinance programmes providing individual housing loans for dwelling improvements can avoid this.

The state is involved in housing provision in most nations, although the scale and nature of this involvement varies greatly. Even in a very low-income country such as Malawi, there have been a range of government housing policies, although few programmes at scale. The involvement of the state in shelter initiatives reflects the importance of housing to citizen well-being; but the nature of their involvement also reflects the politicization of housing provision as politicians seek to control and gain from the allocation of housing and land tenure. Political elites often manipulate the allocation of housing finance programmes to address their political interests; for instance, housing finance in Brazil under the Collor administration was used to secure political support in Congress.[25] In the Philippines, the inadequacies in conventional state housing programmes have encouraged a shift to more market-oriented strategies following the failure of credit subsidies and high rates of default on government loans. What is evident in many contexts is the lack of state support for programmes oriented towards the lowest-income residents.

One key role of the state is to provide the supervisory and regulatory framework for the financial sector. In large part, it was the failure of the state and self-regulatory frameworks that explains the sub-prime crisis in the USA. Loans were given out and sold on in a complex set of financial markets designed to increase the availability of mortgage finance. However, the risks related to such loans were inadequately assessed and/or not fully taken into account. The subsequent problems have been both loan defaults by individual families and related repossession, and the international credit crunch as banks refuse to lend to each other due to fears of bad debt. However, as shown in the papers in these two volumes of *Environment & Urbanization*, there are many positive experiences where loans have been manageable at the household level and the loan-giving bodies continue to be viable organizations. Given the body of knowledge about successful lending to low-income households, why haven't governments and international agencies sought to create an appropriate framework of support and regulation?

In most urban contexts, shelter finance alone can never address the problems faced by the lowest-income groups because the gap between what they can afford and the cost of the cheapest "good quality" unit with infrastructure and services is too high. The case studies noted above emphasize the need for an approach that includes opportunities for tenure security, the upgrading of services and the improvement of dwellings. This is clearly seen in the case study from Angola and the dual roles played by *KixiCrédito* and by Development Workshop, the first providing finance and the second developing new models for land development and lobbying for pro-poor land policies. Another important aspect is a real dialogue between the state and low-income households, so that the limited resources and capacities of each can be combined to maximum effect. For instance, in urban areas in Pakistan, the official bodies responsible for providing water and sanitation were not able to meet needs in informal settlements – but with the introduction of a new model by OPP–RTI, which provided for a realignment of citizen and state contributions, they have been able to provide the "external" water pipes, sewers and drains into which community-managed and financed "internal" pipes, sewers and drains can integrate.[26]

V. INTERNATIONAL FINANCE FOR LOCAL INITIATIVES

Very few official aid agencies support housing finance initiatives. In part, this is because they do not support urban initiatives. But, in part, it is also because of the challenges these agencies face in finding ways to enable flexible locally managed finance to respond to neighbourhood and city-level initiatives while maintaining the required accountability to the governments that provide their funds. Some international NGOs have long supported housing finance initiatives. For instance, housing finance has been central to the work of the UK-based charity, Homeless International and it came under pressure to find alternatives to grant finance to allow its funds to increase the scale of their impact. Homeless International has developed guarantee finance to enable organizations in Africa and Asia to obtain loan finance from local banks. It has also developed another financial mechanism to support housing, the Community Led Infrastructure Financing Facility (CLIFF). This is a capital fund provided through Cities Alliance, on which their partner organizations can draw to allow them to increase the scale and scope of their housing initiatives – for instance, by providing bridge financing for large redevelopment programmes, or allowing larger, more ambitious upgrading programmes. This was tried first in India, working with the Alliance of the National Slum Dwellers Federation, Mahila Milan and SPARC and this received financial support from the UK Department for International Development and the Swedish International Development Cooperation Agency

(Sida). A similar facility is being developed to support low-income housing initiatives in Kenya and the Philippines.[27]

Another example of an international fund supporting housing for low-income groups is the International Urban Poor Fund, managed by Shack/Slum Dwellers International/SDI and IIED. This provides small grants throughout the SDI network of slum/shack dwellers federations to catalyze local initiatives in secure land tenure and basic services. It finances urban poor funds that have been set up by national slum/shack dweller federations and supports community-led advocacy to advance grassroots solutions. Its contribution lies as much in the flexibility of the funds and the locally determined allocations as in the scale of its support. Many of the initiatives it funds receive only US$ 20,000–40,000, but the federations make this go much further than conventional development agencies can as it is combined with the resources and capacities of the federation, the locally negotiated support (often from local government) and the care with which the federation uses the funding.[28]

VI. CONCLUSIONS

It might seem inappropriate to highlight the importance of shelter finance in low- and middle-income nations, given the crisis in the USA and other nations where large numbers of low-income households cannot repay loans. But this crisis does not suggest that financial markets cannot serve low-income groups or that low-income households cannot manage credit. Rather, it highlights the fact that financial services must take account of the vulnerabilities and limited repayment capacities of low-income households. Financial services for low-income groups need to be developed with these groups as they are best able to assess their repayment capacities and develop effective systems.[29] The design of such services needs to take into account the difficult choices faced by low-income households in generating savings, as they struggle to balance potential income gains (microenterprise borrowing), expenditure savings, investments in capacities and relationships (education, marriage) and investments in assets (including housing). Financial services need to have the flexibility to support this complexity.

The examples given above show how far external funding can go if it can support local processes driven by local organizations that make maximum use of such funding. International agencies could do much more with their monies if they were willing to relinquish more decision-making powers and more financial control to local organizations formed by, and accountable to, the urban poor. The many case studies of schemes that provided low-income groups with access to finance also show impacts that go far beyond what was financed – for instance, new community capacities and new relationships between low-income groups and government or financial institutions. Looked at from the other way, external finance, if provided effectively, can multiply and deepen the self-help activities of low-income neighbourhood associations.

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[*Note:* This article is a summary of key issues arising from two special issues of the journal *Environment and Urbanization* on finance for low income housing and community development – published in October 2007 and April 2008. It was also published as an *Environment and Urbanization* Brief in June 2008.]

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[1] In addition to the 20 papers on this topic in the October 2007 and April 2008 issues of *Environment & Urbanization*, a further 19 papers on the topic have been published in earlier issues of the journal – and these can all be accessed on-line at no charge at http://eau.sagepub.com/. These include Ferguson, Bruce and Jesus Navarrete (2003), "A financial framework for reducing slums: lessons from experience in Latin America", *Environment & Urbanization* Vol 15, No 2, October, pages 201–216; also Malhotra, Mohini (2003), "Financing her home, one wall at a time", *Environment & Urbanization* Vol 15, No 2, October, pages 217–228; Frank, Daphne (2004), "A market-based housing improvement system for low-income families – the Housing Incentive System (SIV) in Ecuador", *Environment & Urbanization* Vol 16, No 1, April, pages 171–184; Stein, Alfredo with Luis Castillo (2005), "Innovative financing for low-income housing improvement: lessons from programmes in Central America", *Environment & Urbanization* Vol 17, No 1, April, pages 47–66; and Boonyabancha, Somsook (2005), "Baan Mankong; going to scale with 'slum' and squatter upgrading in Thailand", *Environment & Urbanization* Vol 17, No 1, April, pages 21–46.

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[4] Hasan, Arif (2008), "Financing the sanitation programme of the Orangi Pilot Project–Research and Training Institute in Pakistan", *Environment and Urbanization*, Vol. 20, No. 1, pages 109-120; also Hasan, Arif (2006), "Orangi Pilot Project; the expansion of work beyond Orangi and the mapping of informal settlements and infrastructure", *Environment & Urbanization* Vol 18, No 2, October, pages 451–480.

[5] Mills, Sophie (2007), The Kuyasa Fund: housing microcredit in South Africa, *Environment and Urbanization*, Vol. 19, No. 2, pages 457-469.

[6] Muller and Mitlin 2007, op. cit.

[7] Manda 2007, op. cit; also D'Cruz, Celine and David Satterthwaite (2005), "Building homes, changing official approaches: the work of urban poor federations and their contributions to meeting the Millennium Development Goals in urban areas", Poverty Reduction in Urban Areas Series, Working Paper 16, IIED, London, 80 pages.

[8] Mills 2007, op. cit.

[9] Stavrakakis, Sarah with Ruth McLeod and Kulandei Francis (2008), "IVDP - credit to the women of Krishnagiri and Dharmapuri", *Environment and Urbanization*, Vol. 20, No. 1, pages 31-46.

[10] See Solo, Tova Maria (2008), "Financial exclusion in Latin America or the social costs of not banking the urban poor", *Environment and Urbanization*, Vol. 20, No. 1, pages 47-66.

[11] Cain, Allan (2007), "Housing microfinance in post-conflict Angola. Overcoming socioeconomic exclusion: land tenure, credit and basic services", *Environment and Urbanization*, Vol. 19, No. 2, pages 361-390.

[12] Llanto, Gilberto M. (2007), "Shelter Finance Strategies for the Poor: Philippines", *Environment and Urbanization*, Vol. 19, No. 2, pages 409-423.

[13] See Stein, Alfredo and Irene Vance (2008), "The role of housing finance in addressing the needs of the urban poor: lessons from Central America", *Environment and Urbanization*, Vol. 20, No. 1, pages 13-30.

[14] Muller and Mitlin 2007, op. cit.

[15] Llanto 2007, op. cit.

[16] Boonyabancha, Somsook (2005), "Baan Mankong; going to scale with 'slum' and squatter upgrading in Thailand", *Environment & Urbanization* Vol 17, No 1, April, pages 21–46. See also the ACHR website, www.achr.net.

[17] Boonyabancha 2005, op. cit.

[18] Sheuya 2007, op. cit.

[19] Hasan 2006, op. cit.

[20] Mills 2007, op. cit.

[21] Cain 2007, op. cit.

[22] Solo 2008, op. cit.

[23] Stein and Vance 2008, op. cit.; Almansi, Florencia and Andrea Tammarazio (2008), "Mobilizing projects in community organizations with a long-term perspective: neighbourhood credit funds in Buenos Aires, Argentina", *Environment and Urbanization*, Vol. 20, No. 1, pages 121-148.

[24] See Jones, Nicola Rosana Vargas and Eliana Villar (2008), "Cash transfers to tackle childhood poverty and vulnerability: an analysis of Peru's Juntos programme", *Environment and Urbanization*, Vol. 20, No. 1, pages 255-274.

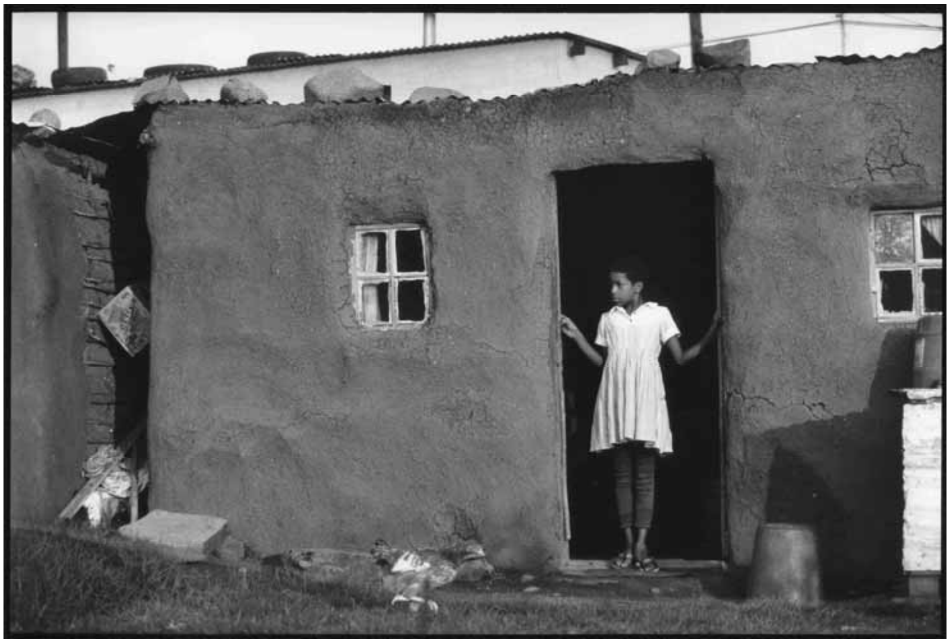
[25] Valenca, Marcio M. (2007), "Poor politics, poor housing; Policy under the Collor Government in Brazil (1990-92)", *Environment and Urbanization*, Vol. 19, No. 2, pages 391-408.

[26] Hasan 2008, op. cit.

[27] Morris, Ian with Kim Mullard and Malcolm Jack (2007), "The growth of 'financial services' provided by Homeless International", *Environment and Urbanization*, Vol. 19, No. 2, pages 471-481.
[28] Mitlin, Diana and David Satterthwaite (2007), "Strategies for grassroots control of international aid", *Environment and Urbanization*, Vol. 19, No. 2, pages 483-500.
[29] For a discussion of this, see Almansi and Tammarazio 2008, op. cit.

HOUSING THE POOR BY ENGAGING THE PRIVATE AND CITIZEN SECTORS: SOCIAL INNOVATIONS AND "HYBRID VALUE CHAINS"

Stephanie Schmidt and Valeria Budinich



Executive Summary

More than one billion of the world's urban residents live in inadequate housing, mostly in slums and squatter settlements of the developing world. While the UN and most governments recognize the basic right to adequate housing, this is yet to be translated into effective solutions to address the housing needs of low-income populations - particularly as population growth and urbanization rates strain the ability of existing systems to keep up with demand for housing construction, but also for water, sanitation, electricity, and transportation infrastructure. Improving the housing conditions of one-sixth of the world's population constitutes a massive economic, social, and environmental challenge. Or, when looking at it from a business perspective, it could represent a sizeable unserved market.

Many governments cannot afford to heavily subsidize the capital-intensive housing sector with the hope of solving the housing shortage. While some progress has been achieved at the policy level, so far most private initiatives sponsored by developing country governments have benefited middle-income rather than low-income families. As a result, the most important players in low-income housing delivery are the poor themselves. Faced with almost no formal options, they use a variety of resourceful, incremental, informal, and often illegal means to meet their shelter needs.

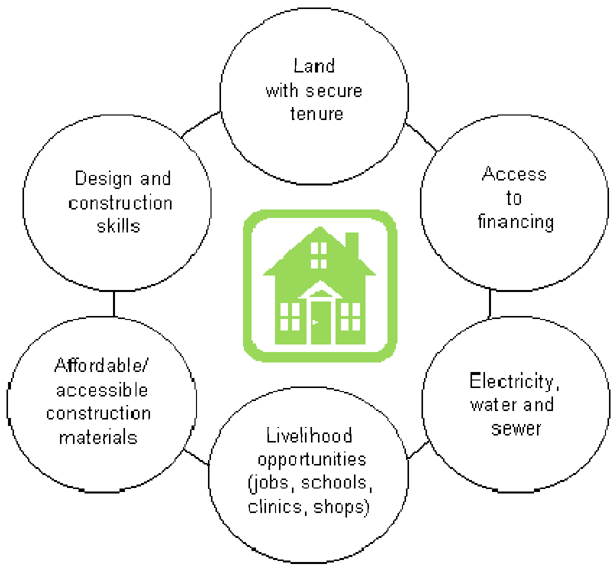
But two new types of actors are emerging to support this effort. On one hand, during the last two decades, the citizen sector[1] has experienced unparalleled growth and has become increasingly competitive. This has resulted in numerous bottom-up social innovations and in active involvement of community groups in housing initiatives. Most of these innovations are powerful and effective at the local level but they often encounter challenges to secure the resources needed to scale-up, with only a few and remarkable exceptions. On the other hand, although most large businesses in the housing sector still consider low-income populations to be an insignificant or unattractive business segment, an increasing number of visionary business leaders have started leading the way to serve these markets profitably and with social impact.

Serving the needs of hundreds of millions of families will require combining the talents and resources of both the citizen and the private sectors. We argue that these concurrent trends provide the right environment for an unprecedented level of business-social congruence to address the central challenge of scale by leveraging the core competencies of both sectors. The first part of this paper will briefly discuss the inadequacy of current housing value chains[2] to serve low-income populations in developing countries. The second part will highlight innovative housing solutions from social entrepreneurs and will illustrate how large corporations have started to successfully learn from these principles to develop new business models capable of delivering not only products and services to low-income communities, but also significant social impact. Finally, we will discuss the need for "Hybrid Value Chains", highly leveraged and commercially sustainable business-social partnerships, to provide large-scale solutions for low-income housing and transform the way housing services are delivered to the poor.

A. Inadequacy of current housing value chains to serve low-income populations

Housing is a complex process that involves the coordination of a wide range of "inputs" and players, even more so in low-resources environments. For the majority of mid- and high-income consumers, the housing industry is adequately delivering affordable and comprehensive services. In contrast, as we describe below, low-income households face a very different situation. In spite of an increasing focus on urban housing and development, informal systems are still the dominant producers in many developing countries - an estimated 60 and 70 percent of Mexico's and Brazil's current housing stock is built informally[3]- because current value chains are not adapted to the needs and realities of this growing market.

Exhibit 1. The various components of housing solutions for low-income populations



Development of housing offerings: The "low-cost housing" that is produced is often inadequate to meet the real needs of the poor for reasons of desirability or quality. Developing an appropriate offer must begin with an understanding of the end-value for the clients themselves. For low-income families, a house is much more than a roof over one's head. Beyond physical shelter, it represents the promise of improved health through more decent sanitation systems and protection from weather; security against violence, vandalism, and theft; productivity given that many informal sector workers use their homes as factories and/or warehouses for inventory, and that services like water and electricity reduce the time spent on household chores and/or extend productive daylight hours; and sense of identity, confidence, and an increased ability to plan for the future. For example, Grameen Bank views housing as a basic human need and a critical element of its members' overall development. As stated in its principles, a shelter is one of the basic requirements for a person to organize her thoughts, discipline her action, and undertake long-term plans. It also enables increased productive capacity of micro-entrepreneurs.

A common misperception is that low-income consumers make purchasing decisions based solely on cost. However, if there is a perceived value, there will be a willingness to contribute. Pride and aspirations, quality, and suitability are important factors to consider. First, housing is a product intimately linked with its owner's sense of identity. Many low-cost housing projects have the effect of branding their occupants as poor or outcasts - often because they look "different." Monolithic block housing can do this, but so can innovative, low-cost, environmentally-friendly housing structures. Instead of creating incentives for long-term investment in their homes, these structures can breed alienation and resentment. Low-income individuals are also rational economic decision-makers who must make the most of every penny to survive - so factors like quality, safety, and durability count. However, free or low-cost services from governments or NGOs often lead to a negative dynamic where providers may not feel obliged to provide quality services and beneficiaries may not feel entitled to claim quality services. Another issue may be the lack of effective quality incentives: for example, for developers who are funded by government subsidies or obliged by law to allocate 20 percent of any new development to low-income housing. Lastly, some low-income individuals may want their homes to be conducive to family and community relationships. For them, single-family detached homes on large plots may be undesirable. Others may need homes designed to support income-generating activities, making a flat roof for drying leaves or an open porch a desirable feature. For all, proximity to social networks, schools, and employment opportunities is key.

Land: Access to land with secure tenure is definitely at the core of the housing issue for low-income households. Not only might they face the risk of being evicted, but even when their situation is secure, lack of formal land title will limit their access to additional services such as finance, water, or electricity. Current property rights policies make it difficult to ascertain legal claim to land, even where families have lived for decades in a location, paid taxes, etc. According to Hernando de Soto[4], the amount of capital locked up in extralegal housing in emerging markets alone currently exceeds USD$9.3 trillion. Land cost is an issue in rapidly-growing cities where land is scarce. Moreover, the number of new plots available is often limited by local municipalities that try to control rural migrations to address issues of urban planning, poor hygiene conditions, and public safety. As a result, informal land developers may take advantage of low-income families who lack options by charging exorbitant prices, selling the same plot several times, not delivering on their sales, etc.

Basic services: The willingness of low-income families to invest in basic infrastructure and services like water, sanitation, or electricity is inversely linked to the risk of being evicted. Nevertheless, even when low-income families are willing to upgrade their housing conditions, many formal service providers are not interested in serving them for legal or economic reasons. On one hand, local laws may prohibit from them serving households without legal land titles. On the other hand, communities may not be organized collectively to represent a critical mass of demand in order to guarantee sufficient return on their investments. Providers may consider low-income families as “bad payers” or even “thieves” who are responsible for setting up illegal connections and degrading their infrastructures. In reality, few companies have tried to develop appropriate strategies and pricing schemes to enable the poor to become regular clients. In spite of these generalized misperceptions, the poor can and often do pay many times more in absolute terms than their middle-class counterparts for the same goods and services. We argue that low individual purchasing power is less an inherent barrier to serving low-income markets than a market characteristic that most private sector providers choose not to innovate around.

Finance: Access to housing finance is another critical bottleneck for the majority of the population in developing countries. Although several potential sources of housing finance for low-income families exist, most of the needs are still unmet. Government subsidies tend to be insufficient or inappropriate; mortgage markets tend to serve only the richest 10-20 percent of the population; in spite of its strong value proposition, housing microfinance is still an emerging industry; and informal systems are not efficient. Only 3 percent of outstanding credit in low-income countries is held in the form of housing loans compared to 27 percent in high-income countries[5]. Highlights on each one of these financing mechanisms are provided below.

a. Government subsidies. The performance of many subsidy programs is not optimal. Ironically, the poor may not be eligible for housing subsidies that will benefit middle-income households, because they operate through the mortgage market or require the recipient to build a house before obtaining the funding (coming back to the issue of upfront construction costs). Beyond this, one of the biggest issues with government subsidies is that they tend to crowd out market-based housing initiatives, which have the potential to be more scalable, sustainable, and therefore more effective in meeting low-income housing needs. Overall, government programs may end up not being cost-effective as they spend money on contractors who are making standard profits in their industries. Quality and size of dwellings are sometimes a second priority.

b. Traditional mortgage market. There are limitless opportunities to use private capital for low-income housing as it has barely been tapped. Low-income households are often excluded from traditional mortgage markets for several reasons:

They may not be able to use their land or homes as collateral because they lack formal property rights; their homes are of low resale value and/or secondary housing markets do not exist; or regulations prohibit it.

They may not be formally employed. In India, for example, 92 percent of workers are informally employed without stable employer-employee relationships.

They may have irregular cash flows and incomes are, in any case, low. Low-income families cannot afford the loan size that would be economical for traditional mortgage financiers to manage. In addition, their preferences often run against it. On one hand, developing countries are characterized by both macro and micro uncertainty (such as property rights insecurity, inflation, or income instability) and under such conditions the poor are naturally reluctant to assume long-term liabilities. On the other hand, many favor improving existing homes rather than moving to new ones in new locations because they value and need to preserve their social networks.

c. Housing microfinance. In spite of recent growth, effective demand for housing microfinance far exceeds supply. As a whole, the microfinance industry, with approximately 50 million clients worldwide, still meets only 5-10 percent of likely demand. Moreover, individual providers face particular challenges in adding housing microfinance products to their portfolios due to: lack of access to medium- and long-term funding; national regulations (e.g., access to savings, taxes); institutional capacity; confusion over the roles of subsidies and financial services; and high fragmentation of the industry. There are about 10,000 MFIs today, of which about 200 or 300 are considered commercially viable and financially sustainable. Only two percent have more than 100,000 clients[6].

Major players in housing microfinance include Grameen Bank (Bangladesh) with over 600,000 loans since 1984, Patrimonio Hoy (Mexico) with over 120,000 loans since 1998, MiBanco (Peru) with over 20,000 loans since 2001, SEWA Bank (India) with over 20,000 loans currently outstanding, and Bank Rayat (Indonesia). However positive trends include an increasing involvement of commercial banks in microfinance through downscaling or on-lending and massive remittance flows. In this context, housing microfinance has emerged as a fast-growing sub-industry within microfinance over the past five years. Although they are still limited, microfinance-style solutions are often more appropriate to the housing finance needs of low-income families:

- Loans are small and repayment periods are short. This matches borrowers' incomes, preferences, and building habits although loan amounts and terms can vary significantly.
- Nontraditional forms of collateral are accepted. These might include co-signers, "peer support" groups, or small items of value such as jewelry, appliances, or vehicles; sometimes no collateral is required at all.
- Ability to pay, even with informal and/or irregular incomes, can be ascertained through standard microfinance techniques. Many housing microfinance providers foster participation in savings groups to reinforce cultures of savings and repayment or require the prospective home loan borrower to complete one or more working capital loans successfully.

d. Informal financial systems. As a result of limitations in the other sources of housing finance, the most common way for the poor to finance their homes is through informal systems. The two most common are local "loan sharks" who charge exorbitant interest rates, and savings groups such as *tandas* in Mexico; *stokvel*, *letsema,* or *ubuntu* in South Africa; or *minga* in Ecuador. Savings may be monthly, weekly, or daily to capture the unpredictable income flows as they occur. Saving for housing is a primary goal for savings groups in many countries; however, realities of life often interfere.

These various illustrations demonstrate that current delivery systems that have typically been developed primarily for middle and upper-class clients are still not adapted to the realities of low-income populations, who are too often caught in a vicious circle. In order to make the housing value chains work for the poor, successful strategies of social entrepreneurs that have been designed, from their inception, for and with low-income communities are particularly relevant.

B. Social innovations in urban housing and urban development

Although public institutions have traditionally played a significant role in providing for housing, new actors are emerging and demonstrating alternatives to traditionally top-down approaches of governments and international institutions. The past two decades have seen an extraordinary explosion of entrepreneurship and competition in the citizen sector that had been sometimes considered as inefficient, unresponsive, and mainly about activism. With an estimated volume of resources of over US$1 trillion and 19 million jobs at a global level, the non-profit sector is already equivalent to the eighth largest economy in the world[7].

Social entrepreneurs[8], practical visionaries committed to finding systemic solutions to address social challenges, have been at the forefront of this transformation. Most of these social innovations typically arise from a market or public sector failure. They often start at a grassroots level and are developed on a shoestring budget, leveraging the power of communities. Successful initiatives are based on leveraged solutions that approach a problem from a different and targeted angle.

Based on recent research on innovative solutions in affordable housing that focused on the main patterns or principles emerging from these solutions, we present below a "mosaic of solutions" that attempts to offer a conceptual framework to the issue of housing in developing countries. The value of the mosaic is also to illustrate a "More-than-the-Sum-of-Their-Parts" effect where individual social entrepreneurs can see the approaches they developed in perspective with those created by the rest of the field. The main barriers to housing for low-income families, real or perceived, are listed horizontally and the main principles emerging from the innovative solutions, vertically. Because innovations usually emerge simultaneously in more than one location and context, you may think of other initiatives around the world using the same How To's as those mentioned here. Note as well that although the best solutions would probably speak to more than one principle or one barrier, we have chosen to emphasize one specific aspect of the initiatives.

These innovative solutions carry many lessons for players such as businesses interested in low-income markets. First, most solutions are based on insights rather than on breakthrough science. Many have actually innovated by rationalizing and improving on traditional community practices rather than by introducing technological innovations. Second, the importance of designing solutions that have a transformational effect and leverage the power of low-income communities will never be emphasized enough. It is about helping communities and individuals to become self-reliant and unlocking their vision for their future. This is particularly relevant for housing given its potential as a springboard for development and as a productive asset for the poor. Lastly, although many innovative approaches are cost-effective, reaching scale to serve a large number of beneficiaries is still the exception rather than the rule. Reasons include the challenge of providing systemic housing solutions (ranging from property laws to financing and construction), the lack of efficient funding for the citizen sector, but also sometimes the resistance of individual players to think big. As we will argue later in this paper, business-social partnerships can be a powerful strategy to enable large-scale and sustainable solutions.

Exhibit 2. Mosaic of innovative solutions for affordable housing

MAIN PRINCIPLES EMERGING FROM INNOVATIVE SOLUTIONS	**MAIN BARRIERS**			
	Unavailability of complementary goods (e.g., land, infrastructure)	**Low individual purchasing power**	**Limited access to housing finance**	**Inadequate current product offerings**
Enable long-term investment	• Assign property rights to decrease investment risk - *Bairro Legal, Brazil* • Invest in services and infrastructure to unlock latent housing demand - *Orangi Pilot Project, Pakistan*	Mobilize low-income families' purchasing power through experience-based learning and demonstration projects - *Slum Dwellers International, Global**	• Market program by speaking to the poor's aspirations - housing as patrimony - to catalyze savings - Cemex/ *Patrimonio Hoy, Mexico*	Enable asset-building and create design that meets low-income communities' preferences - *Housing Stock Exchange, Sri Lanka**
Leverage resources abundant at the local level	• Build critical mass and empowerment for communities to negotiate with government - *Homeless People Federation, S. Africa* • Target already-organized communities - *Baan Mankong, Thailand**	• Use "sweat equity" to reduce labor costs and create new skills - *Mutirões, Brazil*	• Invest in customers' income-generating potential - *YKPR, Indonesia** • Build systems to capture savings for all types and sizes of incomes - *VSSU, India**	• Facilitate community-led design - *SPARC, India* • Utilize local materials and building techniques - *ADAPT, Egypt**

Radically lower the cost of the whole housing delivery process	• Harness the effectiveness of existing informal systems - *Saiban, Pakistan* • Design new electricity distribution channels for slums through cooperatives - *Ashok Bharti, India**	• Aggregate demand to reduce transaction cost - *ICICI Bank, India*	• Reduce the risk of housing finance by building credit history and income generation opportunities - *Grameen Bank Housing Program, Bangladesh*	• Leverage community-led market research - *Slum Dwellers International, Global** • Offer comprehensive solutions - Cemex/ *Patrimonio Hoy, Mexico*
* Organization created by Ashoka Fellows.				

Main principles emerging from innovative solutions in housing

As described below, we have distilled three main principles emerging from successful low-income housing initiatives based on a research conducted in 2005. This work included identifying and researching over 60 social innovations and interviews with over 30 key informants specialized in low-income housing around the world. The quotes inserted at the beginning of each section were obtained during this process.

1. Enable long-term investment

"Poverty is a lack of material conditions, but it is also a lack of hope. Housing fulfills a material need, but also the need for hope."- Alfredo Stein, Swedish International Development Agency, Central America

"Housing can be a key point of leverage in the development process." - Fazal Noor, Ashoka Representative and housing expert, Pakistan

"Under the threat of eviction, there will be no market." - Billy Cobbett, Cities Alliance, and former Housing Minister, South Africa

Low-income individuals must engage in a delicate financial balancing act every day to survive. Making it possible for them to undertake long-term, large investments (or successive short-term investments over long periods of time) requires ensuring the right economic incentives for them, as well as addressing more psychological aspects such as their ability to plan for the future.

Precarious and insecure living conditions heighten the financial risk of any investment occupants might otherwise make in their homes. In an attempt to break this vicious circle, the municipality of Sao Paulo’s Bairro Legal initiative succeeded in providing secure tenure to more than 45,000 families through a comprehensive program from 2001 to 2004. Services included conflict mediation between land owners and squatters, assistance for legal acquisition of land directly and through partnership with the local Bar Association, and microcredit through Brazil’s largest private sector bank. Another innovative market-based initiative that has enabled slum dwellers to build assets and climb the financial ladder is led by Darin Gunesekera from the Wiros Lokh Institute in Sri Lanka. Darin has started a variation of a stock exchange market to raise funds for the construction of new dwellings for poor families who are entitled to certificates to purchase a new home of their preference. This has changed the practices of developers who need to compete for the preferences of the poor. Low-income families can voice their preferences and gain confidence to invest their resources in home improvement.

Unlocking some of the psychological barriers of low-income families to build a better future is the other side of the coin. Slum Dwellers International, a global network of squatter groups started by several social leaders (including Ashoka Fellows Samsook Boonyabancha and Joel Bolnick respectively in South Africa and Thailand) that counts a total of 5.6 million members in 14 countries[9] has defined its programmatic priorities based on people’s aspirations and devised several strategies to enable action and problem-solving among their beneficiaries. These include visits between members from different neighborhoods, cities, and countries in order to encourage learning through real life experience, as opposed to formal education, and generate empowerment. The visible achievements in home improvement are another powerful element to demonstrate that change is possible. Demonstration houses are used to trigger discussion and joint decision-making about design, construction materials, and processes.

2. Leverage resources abundant at the local level

“Look to build self-reliance, not just houses.” - Paul Cohen, Tlholego, South Africa, Ashoka Fellow

“Beyond building a home, community-building is key because there are so many other things poor people need to accomplish together.” - Celine d’Cruz, SPARC, India

“Support the development of housing by supporting the development of the community.” - Oswaldo Setti, Ação Moradia, Brazil, Ashoka Fellow

"Your biggest competitor can be the expectation of free help." - Cheryl Young, SAATH, Ahmedabad, India

Many of the barriers to housing for the poor require political, or at least multi-stakeholder, solutions - for example, securing land, modifying property rights regimes, or convincing electricity providers to serve a settlement. Social capital is probably the greatest asset of low-income communities who can achieve much by joining forces. This is precisely the key break-through of microcredit that replaced traditional loan collateral by social collateral. The South African Homeless People's Federation (SAHPF) is an example of a truly community-based organization designed to be inclusive for the very poor. It uses collective action as a core strategy to strengthen communities and enable them to initiate and manage changes in the areas that they have prioritized such as housing. The core strategy to organize communities is the creation of daily saving groups where members, mostly women, learn to trust each other and build a discipline. Saving groups are then federated at the neighborhood, regional, and national levels.

More generally, there is a great potential in enabling low-income communities and individuals to become self-reliant. They have tremendous assets they can contribute including a great deal of resourcefulness, skills, time, and the ability to save. It is not a lack of skills that makes poor people poor. Poverty is not created by poor people but often by the institutions and policies that surround them[10]. There is therefore a great need for transformational and market-based approaches to housing, as opposed to hand-outs, that leverage these assets to provide long-term and sustainable solutions. This also requires a different perception of the "poor" not based on pity or mistrust but on openness and belief in their potential. The movement of "mutirões" that started in Brazil and other parts of the world in the early 1980s is based on individuals who come together after work and during weekends to construct their homes and neighborhoods through mutual self-help projects because they are unwilling or unable to rely completely on the state. Despite the fact that this process takes longer than using professional full-time constructors, this approach enables them to reduce costs and effectively teaches self-management and other administration skills to the community. Another initiative that illustrates this principle is ADAPT in Egypt led by Hany El Miniawy. It leverages locally available materials as a substitute for conventional construction materials as well as ancient building techniques that are more adapted to weather conditions and culture, given the limited resources available.

Leveraging the productive potential of low-income communities that can access the inputs needed for success is an important strategy that enables them to increase their purchasing power. YKPR in Indonesia organizes groups of families to apply collectively for credit from the government housing bank that is unavailable on an individual basis and it coordinates repayments on a calendar that accommodates the seasonal nature of incomes. The negotiated credit is "three-way," intended to cover land acquisition, house construction, and income-generating investments to help cover repayments on the loan. The government housing bank now considers them more reliable than its traditional clients and makes additional efforts to achieve customer satisfaction - for example by collecting loan repayments at customers' doorsteps. Although the model was initially developed for rural areas, the principle is applicable to urban settings.

3. Radically lower the cost of the whole housing delivery process

"Understand housing as a process, including not only construction but also land acquisition and title, provision of infrastructure and services, planning and negotiation, financing, and community organizing." - Fazal Noor, Ashoka Representative and housing expert, Pakistan

"Understand what families want…and the fact that it's not what we think they want." - Oswaldo Setti, Ação Moradia, Brazil, Ashoka Fellow

"The poor are the world's experts at managing money…They just face a very narrow range of choices." - Asian Coalition on Housing Rights

Thinking holistically about how to make the overall housing transaction affordable to low-income households rather than reducing the cost of individual components such as cement or labor is critical. Saiban in Pakistan is a remarkable initiative that makes the overall housing transaction affordable and convenient for low-income households by leveraging the benefits of informal housing processes. The organization finances the purchase of unserviced plots of land, and leaves housing and infrastructure to be developed incrementally as each household accumulates the money to pay for them – as occurs in the informal sector. While leveraging informal processes, the organization also improves on them by providing secure land tenure and organizing residents to plan and negotiate for additional services. Security in Saiban settlements is higher; costs of living are lower; and services are obtained years faster than in comparable informal settlements.

Radical cost reductions can be achieved by streamlining the whole process and switching some of the costs and responsibilities to clients - an interesting parallel with the Internet revolution that enabled many companies to rethink their business models by putting customers and partners to work thanks to the Internet interface. Other strategies to increase the profitability of distribution in slums and rural areas include multi-purpose distribution channels and demand aggregation. Examples from other industries such as e-Choupal, an ITC-led initiative for small farmers in India, could inspire innovations in housing and building materials. With regards to housing finance, Grameen was one of the pioneers and has already enabled the construction of over 600,000 houses in Bangladesh. Unlike other financial institutions, Grameen ventured into giving housing loans based on the philosophy that investment in shelter for the poor is productive. Its strategy for providing housing microfinance profitably uses the same organizational infrastructure that it uses to make income-generating loans, and restricts eligibility to clients who have developed successful credit histories for four years to reduce risks associated with housing loan products.

Additionally, an in-depth understanding of potential customers' needs and preferences is necessary to get the highest return on investment by focusing on specific features or components that really matter to end-clients. But conventional wisdom often does not apply in low-income markets and market data is scarce. CEMEX learned this the hard way when it began offering small bags of cement in order to minimize waste, logically thinking that it would be more convenient and affordable to low-income Mexican households without transportation means and with limited disposable cash. However, they soon realized that these bags were not popular as customers valued the social status associated with having a large bag of cement propped up in front of one's house[11]. This constitutes just one example of the multiple intangibles that play a role in low-income customers' preferences.

C. Business in development: an increasing trend

Another trend parallel to the transformation of the citizen sector over the last two decades is the increasing role that businesses have been playing in local development by going beyond mere corporate social responsibility. There is a growing realization that doing business with social impact is possible, which is blurring the gap between conventional territories of development players and businesses. This is particularly critical in sectors such as housing and urban development that have the potential to create significant social impact by tremendously improving conditions of life, productivity and health of low-income communities.

Traditionally, large companies have served only about 20 percent of the developing country markets. However, expanding one's traditional markets is increasingly becoming a strategic matter given the rate of growth and the sheer size of low-income markets, in addition to being an effective way to improve one's socially responsible image. 98 percent of population growth until 2025 is expected to come from developing countries. If efficient markets and appropriate product offers, such as financing and delivery systems plus secure land tenure were in place, the global market potential could be in the order of hundreds of billions of dollars. Private companies could not only benefit from this sizeable business opportunity but their investments could also serve as critical enablers of the infrastructure and institutions needed to develop a capital intensive sector such as the affordable housing one worldwide.

But successfully entering these markets requires learning new skills and adjusting business models to different and rapidly evolving market dynamics[12]. The housing market is no exception. While the aggregated power of low-income communities is significant, individual transactions are small and incomes are low. Can most people in urban slums afford to build a home? Most businesses are not yet convinced by this business proposition. In the meantime, many of these potential customers have found ways to build their homes, even when it takes a decade to complete them. They pay top prices for their building materials, tend to hire untrained masons who use poor construction techniques, self-construct, or access loans with exorbitant interest rates.

A house will progressively evolve with the flow of life: a room may be added when a new child is born, a son marries or relatives move in. Just as commercial banks used to claim that the poor were not bankable prior to the microfinance revolution, most business players in housing behave as if this market was not worth entering. While banks actively targeted large volumes, Mohammad Yunus departed from conventional wisdom based on his fine understanding of the local culture: "I decided to do exactly the opposite of traditional banks. To overcome the psychological barrier of parting with large sums, I decided to institute a daily payment program. I made the loan payments so small that borrowers would barely miss the money."[13] Twenty years later, after mastering ways to keep transaction costs to a bare minimum, microfinance is considered as a sound investment and large private banks are moving in.

One of the most remarkable examples emerging from the private sector is the case of Patrimonio Hoy ("Assets Now"), a program launched in 1998 by CEMEX, one of the top three global cement manufacturers. This case illustrates how a company successfully translated the social innovation of microfinance to the construction material industry, expanded their core business model to overcome the main barriers faced by their potential customers (e.g., access to financing), and found cost-effective ways to serve this market. It also an illustration of a company actively seeking what constitutes an attractive value proposition for low-income populations. PH was started after CEMEX issued a "Declaration of Ignorance" and sent a team to the slum for several months to understand how low-income families lived and built their houses. It acknowledges the sense of empowerment produced by a better home that enables low-income clients to break from their hopeless resignation, the importance of social capital, and the critical issue of trust by the community—notions that are typically considered as "soft" or dubious by businesses. Also worth stressing is that unlike typical innovations in the construction material industry, PH's breakthrough is about innovative business processes rather than technology-based products. [14]

Mexico has one of the worst housing shortages in the world, with the need for 1.5 million new homes annually and another 3.7 million existing units that are estimated to be inadequate. Part of the initial motivation of CEMEX to start PH was their realization that low-income segments were an unusually stable market as the demand was not as strongly affected by Mexico's devaluation crises or by government spending cycles. It observed that 40 percent of the cement consumption in Mexico came from the self-built, low-income segment, representing potential sales of US$500-$600 million per year. The challenge then became finding a way to transform this housing need into a viable market opportunity.

In most Mexican communities where incomes are low and cultural norms may mitigate against saving for the future, people tend to build their homes incrementally as money becomes available. This can be a long process, taking up to four years to build an additional room. PH's model addresses the financial constraints of low-income families by building a system for saving and planning ahead. PH marketing emphasizes "patrimony" – an asset and a legacy to pass down to one's children – as opposed to construction materials. Its offer is tailored to the reality of how the poor build their homes, one room at a time, with their own labor. PH makes it attractive with a "total housing solution" that encompasses financing, cement, and various other building materials, technical assistance, storage, and quality customer service. Since its creation in 1998, it has enabled about 130,000 families to improve their homes, saving an average 2/3 of the time and 20 percent of the costs of traditional methods. PH's current client base in Mexico is already larger than all subsidized housing programs combined and unlike them, PH is not limited in its growth by the amount of available subsidies.

PH's comprehensive offer includes financing, construction materials, technical assistance, and other benefits:

- *Financing:* While studying low-income families' habits, CEMEX found that while 70 percent of the women involved in traditional saving cooperatives were saving for housing, only 10 percent succeeded in actually spending their savings on housing. PH's scheme therefore provides a "system" for those who do not have the discipline to save and a solution for those without credit history or collateral through a combination of micro lending and community savings. It consists of a 70-week payment plan in which members make weekly payments of about US$14 through an individual or group plan. Credit is provided in the form of materials, delivered in several installments agreed on by the member. It has achieved impressive repayment rates above 99.2 percent, demonstrating once again that the poor can be trusted customers.
- *Construction materials:* CEMEX has not developed lower cost or lower quality products for low-income markets, but instead offers its standard products. In addition to cement, PH's plan includes more than 200 other building materials provided by distributors. PH negotiates discount prices with distributors and suppliers thanks to the considerable buying power of CEMEX. Quoted building material prices remain constant for the duration of the plan, a great protection against inflation. At each installment, materials are delivered immediately or stored in PH distributors' facilities until customers are ready to build.
- *Technical assistance and other services:* New members receive free advice from an architect /engineer about design, planning, selection of materials, and construction techniques. This assistance is very valuable to do-it-yourself homebuilders who often can waste up to 30 percent of materials due to inappropriate methods. Some variations of PH's offer include a partnership with the Mexican government to work on public infrastructure projects financed partly by households and partly the local municipalities (Calle Digna).

More than 130,000 families have gone through PH, improving their living conditions and building rooms faster and at an average 80 percent of previous costs. The improved homes have also a higher market value, thereby directly increasing the net worth of PH members. PH aims to reach over one million families by 2010 and is expanding to Colombia and Venezuela this year. It does not currently target the very poor, but those earning between US$1,825 and US$5,475 per year, mostly in urban and peri-urban areas. With regards to social impact, PH has also created jobs for thousands of door-to-door promoters who earn an average US$200 a month for two to three hours work per day. From a business perspective, the program is now profitable, generating a net income of approximately US$1.3 million in 2004 and total sales of

US$42 million since its inception. Cement consumption has tripled among its low-income, do-it-yourself customers where PH is present and PH has improved CEMEX's reputation as a socially responsible business.

From the beginning, PH was set up as a separate division within CEMEX to allow more flexibility in terms of salary structure and corporate culture among other reasons. It has now more than 62 offices in 29 cities of Mexico. Each cell has a general manager, an engineer or architect, a supply manager, and a customer service representative. Most of the employees come from low-income communities. With regards to distribution, PH selects distributors via a demanding set of criteria, including good relationships with CEMEX and the capacity to store and deliver materials to hard-to-reach neighborhoods. This is a critical element as PH realized the importance of impeccable delivery despite the logistical challenges in urban slums in order to overcome the trust issues of its members.

Overall, PH's marketing strategy aims at excellent customer service and trust building. In close-knit communities where relationships are highly valued, word of mouth is the number one marketing channel. PH leverages this channel by using local promoters who work on commission, 98 percent of them women who have established credibility among their social networks. The introduction to PH starts with a group session and a small party is thrown when a member completes a room. Building on these principles, PH and Ashoka are currently testing alternative strategies to leverage the knowledge and grassroots-based infrastructure of already existing citizen sector organizations. Patricia Nava (founder of Sisex, a reproductive health network), ONI (a leading nutrition organization), and the food bank of Toluca in Mexico are engaging members of their networks as promoters or potential members of PH. In return, the partnering social organizations receive a commission for referring clients to PH and are able to advance their social mission by reducing domestic violence and providing more decent living space for the participating families. As CEMEX/PH move further into lower-income segments and/or rural markets, these types of partnerships will become increasingly important.

Patrimonio Hoy is a pioneering program and is part of a rapidly emerging trend. Lafarge and Holcim, the other two corporate cement giants have also started initiatives to grow their presence in low-income markets. In addition, various national and local players that may not have as much visibility on the global scene have developed innovative solutions thanks to their greater proximity to low-income communities. Looking more broadly at urban development beyond housing, water and electricity companies are also experimenting with creative schemes designed to make the market more inclusive of low-income customers. Two noteworthy examples from the Philippines and Colombia are briefly introduced below. As competition increases, low-income communities will benefit from a multiplicity of affordable offers and much more effective commercialization channels.

Manila Water in the Philippines, whose customer base is more than half urban poor, returned 16 percent on employed capital in 2004, the best showing amongst a set of peer companies in Asia. When it won the concession of a neighborhood in Manila in 1997, it faced numerous challenges: one-third of the population did not have water, only 10 percent had sewerage services, and as much as 65 percent of the water that left the treatment plant brought no revenues due to leakages, illegal connections, or measurement problems. Low-income communities were the major source of pilferage, accounting for up to 40 percent of the total lost revenues.

In order to address the issues faced by low-income communities with regard to high installation costs and difficulties in collecting post-paid services, Manila Water developed a novel collective installation and billing scheme. Clients can choose between an individual or group scheme (chosen by 70 percent of the urban poor) that not only lowers the connection fees for customers but leverages social capital and peer pressure for bill payment for the provider. Manila Water also launched a program to educate consumers on the risks of illegal connections where water was often sold for seven times more than what Manila Water would typically charge. They realigned their philanthropic strategy to support development programs that had the effect of gaining the support of the communities. Last but not least, they resolved an important legal obstacle by securing regulatory support. In the past, users were required to have a land title to secure piping and faucets on their premises – creating incentives for illegal connections – but now providers are allowed to serve informal settlements[15].

AAA in Colombia is another case of providing water services. The company was on the verge of leaving the region of Barranquilla in Colombia to pursue more attractive investment opportunities in Chile when some of the local management staff convinced the company to start a systematic approach towards low-income markets that combined market mechanisms with strong outreach to political and citizen-sector organizations in the region. Major investments were made to increase the quality of the water and the number of people with access to water and sanitation. Beyond revamping its database to improve information about clients and its customer service, it became possible to collect weekly or even daily payments thus tailoring the collection cycle to the low cash reserves of the poor. Bills were simplified for greater comprehension, the service line was fully subsidized by the government, and the meter was repaid in 36 months, again addressing the inability of the poor to make large cash outlays. Mobile units were created to allow customers to pay without leaving their neighborhoods, cutting down on transportation costs.[16]

D. Advancing housing solutions for the poor through Hybrid Value Chain collaborations

While an increasing number of businesses are starting to explore low-income market opportunities, most of them soon realize that they need to learn about these markets and find ways to access them. Businesses may have strong technology, logistics, and investment capacity but, more often than not, they face major challenges when it comes to developing the necessary market knowledge about low-income communities, the distribution channels in slums or rural areas, and building trust-based relationships with these communities. Not only have companies rarely considered these market segments as a source of potential clients but there is little formal market data available.

In contrast, over many years the citizen sector has built grassroots networks and alternative service delivery systems and demonstrated significant outreach capacities to low-income families throughout the developing world. These networks cover a diverse array of specialized services targeting basic human needs like education, healthcare, and access to financial services. While by themselves most of these networks are not profitable, they constitute an outreach infrastructure that can serve multiple purposes, one of which is the delivery of valuable products and services to the poor. We argue that these networks are the cornerstone to establish a new delivery infrastructure capable of reaching hundreds of millions of people through market-based solutions.[17]

To the extent that businesses - particularly those involved with basic human needs like housing, water, and electricity - can learn to leverage these social networks and their market knowledge, they could substantially reduce the investment needed to develop these underserved markets as well as accelerate their entrance into these new markets. It makes business sense and it creates social value thanks to CSOs and businesses offering complementary services to low-income clients. One example of this is the alternative growth strategy for Patrimonio Hoy that CEMEX and Ashoka are currently testing by leveraging existing social networks as promoters of PH's services rather than solely relying on individual promoters.

In order to do this, CSOs must sensitize themselves to the possibility of building new types of commercial collaborations that would facilitate their access to the specialized infrastructure and financial resources typically available only to businesses, and to significantly increasing their impact. On the other hand, businesses will need to change their perception of the citizen sector, recognizing them as co-designers of solutions and finding ways to compensate them fairly for the assets and skills they bring to the partnership. Alternatively, they could also consider adopting and scaling up specific elements of social innovations developed by CSOs. Some businesses have already led the way, such as Lafarge which has placed partnerships with CSOs at the core of its philosophy, starting with a broad global collaboration in the field of environment with the World Wildlife Foundation and extending it to housing with Habitat for Humanity - an opportunity for the staff to get engaged in housing projects but also to exchange good practices among business units. Based on these experiences, Lafarge is now exploring the next stage of partnerships for its low-income market initiatives in South Africa and India among other locations.

From providing access to basic services (water, sanitation, electricity) to distributing building materials, there are multiple value-added steps that constitute the housing value chain. Enabling the transformation of low-income populations into viable customers requires carefully synchronizing the interventions of numerous partners including community development organizations, social networks, building material companies, large and informal constructors, microfinance institutions, commercial banks, legal services, and the individual customers. As shown in Exhibit 3, what emerges is a "hybrid value chain" in which the business and citizen sectors work together to achieve maximum output:

Exhibit 3. Examples of opportunities for Business/Social Hybrid Value Chain collaborations in housing

Critical steps	Main barriers to serve low-income markets profitably	Potential value proposition of citizen organizations	Examples of main players needed
Access to land	• High cost of urban land • Inefficient/ inappropriate property rights system • Heavy migration flows	• Organize communities • Negotiate new land allocation • Suggest legal changes • Offer financing schemes	• Municipal governments Lawyers • Social movements and citizen groups
Access to basic services	• Illegal settlements • High cost of infrastructure • Small individual transactions • Fear of low payment collection	• Organize communities • Create demand for better environment /change mindsets • Aggregate demand • Offer financing schemes • Manage alternative land development model	• Municipal governments Developers • Water, sanitation, and electricity companies • Social movements and citizen groups
Financing	• Lack of collateral • Lack of regular and verifiable salary • Limited outreach of housing microfinance	• Organize communities • Deliver financial services • Promote housing loan programs • Provide added services such as technical assistance	• National / local governments • Committed investors capable of mobilizing the creation of a housing fund (e.g., investment banks, private investors, consumer banks, building material manufacturers/ retailers) • Microfinance institutions and citizen groups

Construction process	• Small individual transactions • Limited financing available • Limited construction skills • Lack of existing distribution channels in slums	• Organize communities • Create demand for better environment / change mindsets • Aggregate demand (for construction materials for example) • Provide alternative distribution channels • Provide technical assistance (create new skills and employment opportunities)	• Construction material companies • Distributors • Constructors (large and small) • CSOs

The above table illustrates the fact that businesses will be able to enter low-income markets more rapidly and profitably if they learn to tap into the knowledge and resources of citizen organizations. It also highlights the need for widespread collaboration across the industry to unlock demand and create opportunities for mutual value creation. Multi-partner collaborations are required to create an "ecosystem" because many services are interdependent and feed each other. If there is no land security, there will be no willingness to invest in services or housing beyond the basics - if there is no financing, there will be no opportunities to advance construction, and so on. In addition, looking beyond the traditional economist's perspective is critical. Designing offers based on a virtuous cycle where low-income communities are not only consumers but also producers is critical for economic and social value as new incomes generated by providing employment will also foster long-term demand for housing products and services.

In order to do so, a new vision of partnerships is necessary - one that is centered simultaneously on profit and social impact and that leverages the core competencies of all partners. These include in-depth understanding of markets and the ability to organize communities for citizen groups, and strong financial, technological, and logistical capacities for businesses. From the business perspective, these partnerships that are breaking from the philanthropic paradigms and thus are not limited by corporate social responsibility budgets are still scarce. They have the potential to generate a "win-win-win" value proposition:

- Improved products/services for low-income communities, empowerment, and possible employment opportunities;
- Accelerated social impact (by providing products that address basic human needs and leverage the business sector infrastructure) and new sources of revenues (based on sales commissions or flat fees, as negotiated) for the social partners;
- New markets, an improved image, and staff retention for businesses;

E. Reflections on the concept of Hybrid Value Chain

Ashoka is committed to help foster this new generation of partnerships in areas of high social impact potential such as housing, water and irrigation, and health. "Hybrid Value Chain" collaborations as we have named them, represent a systemic change in the way businesses and CSOs interact. These are not punctual, opportunistic, and contractual relationships between businesses and CSOs but strategic alliances that leverage resources to better serve communities. They are commercial in nature and based on the premise that companies and social entrepreneurs can interact commercially as equals. In this scheme, CSOs are not only becoming alternative distributors but critical enablers, value creators, and catalysts to ensure that all of the parts of the system that are required are in place, such as land, services, construction material, skills, and financing. This requires a profound change of mindset and culture for both businesses and CSOs. Successful demonstration projects involving industry pioneers are needed to build a new paradigm that becomes standard practice for both businesses and CSOs, and that will be replicated independently.

While we recognize that there is a cost associated to develop partnerships and that business-social collaborations may not always be the most cost-effective approach to developing low-income markets, we believe that this is typically a superior solution, provided certain conditions apply. These include products or services of high social impact (required to engage CSOs on a sustainable basis) and high-investment products or services that typically require a cluster approach with value-added services that allow low-income customers to fully benefit from their investment. This necessary cluster includes services of mixed financial returns such as financial services, community empowerment/mobilization, or capacity building that range from market-based rates to merely philanthropic support.

In spite of the many cultural, strategic, and operational challenges ahead, the potential is massive and pioneers will benefit from first mover advantages. The key to these partnerships is to identify the right partners and to ensure alignment at the strategic level, complementarities at the operational level, involvement of low-income communities, and the necessary resources to design, launch, and scale the new business models.

Basically, creating an enabling environment for these new partnerships relies on several factors that include people, money, policies, trust, and collaboration. First, visionary leaders and entrepreneurs are needed because this is not business as usual for companies or for CSOs. Then the right kind of capital for the different stages of the ventures is necessary: patient seed capital that will enable the search for appropriate solutions, innovation, and support to CSOs that must manage major internal changes when they "convert" from being grant-dependant to income-generating entities that provide services to businesses; and investment capital for the scaling-up stage. Accessing seed funding is currently a challenge for most companies because R&D is typically understood as innovating products rather than processes. Moreover, according to classical thinking, the business of business is business: all investment opportunities within a corporation are subject to internal arbitrage based on future returns. As we argued earlier, low-income markets offer sizeable growth opportunities in addition to more intangible benefits such as social image and goodwill with government and communities themselves, but in some cases a compromise on margins is required especially when targeting very poor populations. There is therefore a need for a new type of hybrid capital that will take economic and social returns into account as well as for different types of investors to fund the different pieces of the mosaic of variable returns.

Although we advocate a greater level of business-social congruence, we do recognize the critical role of government as an enabler of low-income housing. Ensuring the safety of urban development is one dimension. With regard to financing, government incentives to attract investments in these markets could make a big difference, as could mixed financing models. Taking again the example of Patrimonio Hoy, CEMEX has already envisioned leveraging partly public subsidies and partly individual contributions to reach lower-income segments and expand their saving program to infrastructure improvements. Microcredit schemes could also be more widely adopted by public housing programs to reach more beneficiaries, reduce up-front payment requirements, and increase individual ownership and responsibility towards their homes, improving the chance of commitment to further improvements in homes and communities in the future. Although relying on communities' micro savings and informal processes typically takes more time to complete construction, it makes achievements visible quickly and progressively builds confidence about what can be accomplished.

Optimal solutions to address the massive shortage of adequate housing are yet to be found but it is clear that given the magnitude and the nature of the needs, no sector can deliver services by itself. Forward thinking business leaders, social leaders, and investors are needed to develop affordable housing solutions at a large scale and to take the lead in tackling the various dimensions of the systemic solution. We look forward to continuing the dialogue with these various players.

We also want to recognize some key questions raised by this new paradigm and open up the dialogue. Market-based approaches enable financially sustainable solutions to low-income communities, but how much profit is ethical in these market segments? Given that markets do not always work efficiently in low-resource environments, what support structures need to be created? How much can businesses collaborate versus compete to address the massive social challenge of one billion people living in slums? Are shared investments possible to develop an enabling environment? To some extent, industry-level dynamics have started in the environmental field. Can this alliance model be applied to develop low-income markets commercially? Lastly, if the citizen sector contributes to the creation of new wealth for private investors, how can we then economically value their contributions? How do we value social capital and intellectual property embedded in social innovations that they bring?

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About Ashoka:

Ashoka is a global network of social entrepreneurs. Since its creation 25 years ago, it has invested in over 1,700 social entrepreneurs in 62 countries through a "social venture capital" approach as a way to address major social challenges with systemic responses. Ashoka Fellows are selected for their innovative and practical solutions to social needs. Based on these innovations, Ashoka's Full Economic Citizenship initiative focuses on spreading successful solutions for low-income populations - harnessing the potential of commercially sustainable business-social partnerships ("Hybrid Value Chains") to reach significant impact. www.ashoka.org.

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[1] Ashoka has adopted the terms "Citizen Sector" and "Citizen Sector Organization" instead of negative definitions such as "Non-Profit" and "Non Governmental Organizations."

[2] The term "Value Chain" popularized by Michael Porter in the 1980s refers to the key value-added activities involved in the delivery of products and services to end-customers including distribution and sales of construction materials, construction and financing in the case of housing. By "Hybrid Value Chains" Ashoka refers to new types of commercial collaborations between businesses and social organizations that leverage their core competencies to improve

the delivery of essential products/services to low-income populations. Hybrid Value Chains typically mobilize various actors from both sectors, each managing its own value chain.
[3] Sources: Daphnis Franck and Bruce Ferguson. Housing Microfinance: A Guide to Practice. Kumarian Press, 2004; Cement Association of Brazil Portland.
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[5] Source: Hernando de Soto, ibid.
[6] Source: ResponsAbility's discussion paper "Engaging the private sector". <http://www.responsability.ch>
[7] Source: "The 21st century NGO: In the market for change", SustainAbility, UN Global Compact & UN Environment Program Publication, London 2003. (Note that this excludes religious congregations).
[8] For more on social entrepreneurship, see: David Bornstein. How to Change the World: Social Entrepreneurs and the Power of New Ideas. Oxford University Press, 2004.
[9] SDI is definitely one exception within the citizen sector with regards to scale. Its organization as a network as opposed to a direct service provider has enabled it to grow rapidly.
[10] Source: Muhammad Yunus, Commonwealth Lecture. 2003.
[11] Source: Flores, Letelier and Spinoza, Developing Productive Customers in Emerging Markets. California Management Review. 2003.
[12] Although we recognize that 'the poor' are not an homogenous group and different strategies may be needed by geographic locations, income levels or social groups, this is not the focus of this paper.
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BRINGING LOW-INCOME CONSUMERS INTO THE MARKET IN COLOMBIA:

HOME IMPROVEMENTS THAT MAKE A DIFFERENCE

Roberto Gutiérrez

Ana Delia Ibarra, a 40 year-old mother of three, is one of 80,000 Community Mothers who work in poor neighborhoods in the cities of Colombia. Back in 1986, when President Virgilio Barco created the Community Homes day-care program, many of these women were already organized to care for children — their own and those of other mothers. Ana was able to join the program in 1996 because she had her own house, a high school diploma and experience with children. She brought together 20 of her neighbors' children, but although she was an experienced childcare provider, she faced typical difficulties such as financial deficit, criticisms and lack of formal training.

As a girl, Ana and her family moved to Bogotá from the faroff city of Palmira for better opportunities. She lived with her mother on the outskirts of the city even after she was married and had children of her own, until a friend of her husband Noel offered the family a lot in Usme, a neighborhood of some 250,000 residents on the fringes of Bogotá. Recalls Ana, "We paid a third of the price and the rest in monthly quotas. When we finished the payments we moved close by and began construction." The family laid the foundation and, two years later, raised the house in slabs and later added other material piece by piece.

Ana's day care functioned on the first floor of her house; there were two rooms, a kitchen and a bathroom with plumbing but no tile. The upper floor was halfway constructed. In early 2006, a Bogotá Health Department visitor said she would have to tile the bathroom and kitchen for "hygienic reasons." Since 2001, the health department had been promoting such improvements, and daycare facilities that did not meet hygienic standards were shut down. Ana, like the other 670 Community Mothers of Usme, didn't have the income to upgrade their homes and they would be visited again in six months.

In February 2006 social worker Haidy Duque, who had worked for 11 years in Usme with women seeking refuge there from Colombia's long-lasting internal war, arrived to Ana's Community Mothers cooperative with an offer. Ceramics of Colombia (Colcerámica), a branch of the Corona Company founded in 1952, invited them to participate in a project to improve their housing. Ana and her colleague Patricia Abril accepted.

An offer long in the making

In the beginning of the 1990s, Colcerámica enjoyed a monopoly position in the market. The company's different businesses such as tiling, porcelain toilets and faucets were managed as one business and were offered on the market as distinct brands which, according to Carlos Espinal, director of Mass Marketing, "we would continually invent to compete with ourselves." The marketing of products with the Corona label, with high technical and design specifications, was geared to middle and high-income groups; the Mancesa label was geared to the lower-middle and lower-income markets.

When Colombia's government lifted most of its trade restrictions in 1991, foreign companies entered the market with better prices for the middle and lower segments. Colcerámica's participation in the market diminished. To recuperate lost terrain, in 2000, the company decided to manage three independent business units. Tiling remained with the Corona name, but the company sought to offer a new product with lower design specifications at a very low cost, launching the Ibérica line in 2003.

More than particular product characteristics had to change in order to achieve a low cost with Ibérica; for one, the portfolio of products within the line had to be austere and efficient. Its value proposition was different from that of Corona; according to the Sales Director of Ibérica, "It's a product with an excellent ratio of quality and price, with no publicity, no marketing, made for purchasing in large volumes." Part of the strategy was to separate the outlets of the two brands; local wholesale and large retail stores were used as channels to attend to strata 2 and 3 (the Colombian Department of Statistics classifies the population in six socio-economic strata; the highest income earning Colombians belong to level 6), and where the Corona brand was sold at a lower price, the product was collected and offered as the Ibérica brand. Local wholesalers were in charge of having the product closer to the final consumer. Several other **internal changes** were required to lower the cost; for example, Ibérica orders were consolidated and sent by the bulk to distributors in 15-ton trucks. Transportation of small orders was limited to the high-end product lines.

The Ibérica line allowed the company to compete in the lowest income segment of the market. By 2006, the Ibérica line was so successful that sales surpassed production capacity. Nevertheless, the growth goals of the company kept the directors attuned to new business opportunities.

Carlos Espinal was put in charge of developing a market for Ibérica. To avoid the problems faced by other companies entering this segment, Carlos contacted Ashoka to identify a social entrepreneur who could facilitate contact with potential consumers. This multinational organization has invested in social leaders, since 2003, in an initiative called *Full Economic Citizenship* that develops capacities and opportunities so that citizens may participate in the global economy. Ashoka's mediation role was not immune to the problems of lack of confidence between business people and social entrepreneurs. Among Ashoka's fellows, Haidy Duque liked the proposal. She thought the Colcerámica products would improve the living conditions of the women she worked with and, furthermore, she knew Corona to be a socially responsible organization. The Corona Foundation was one of the best known corporate foundations in the country, part of its work being with grassroots organizations.

Three months later Haidy and Carlos set to work to create a friendly **external environment** to Colcerámica and its Ibérica line. They understood that "a social entrepreneur must continue his or her activity in order to develop a hybrid value chain, and to join knowledge and action to construct a model." The first actions were to choose a location and study its housing issues, to understand very well the cultural and political context in which they were to operate, and to identify where the project could begin with a certain amount of guaranteed success. Because of her experience, Haidy suggested Usme, where the entire population belonged to strata 1 and 2. Using student interviewers, they gathered basic information with 80 surveys in the area. Having determined the potential market, Ashoka and Colcerámica were convinced of the viability of the project. For Carlos, "the contact with Usme was excellent. The only thing I missed was bringing people from marketing here to undermine the idea that executives won't get their feet muddy."

For low-income consumers, buying materials from traditional merchants meant buying more than they wanted, paying in cash and doing all the work oneself: design, purchase, pick up of material, and all the labor. Haidy and Carlos devised several options to change the way in which the company related to its final customers. A new model for selling Ibérica products to low-income citizens was proposed, but it created uproar within Colcerámica's sales force. In the new model, a community promoter offered the product directly at the home of the low-income consumer, providing advice and a variety of payment alternatives. Colceramica's professional sales force expressed its doubts about the capacity of unskilled women to become knowledgeable in product characteristics and in sale processes. However, community members as sellers were in a much better position to overcome three barriers: the lack of income of consumers, their belief that they could not bring about their own development, and the barrier of entering the home of a potential consumer.

To create a new channel, Haidy and Carlos thought of the possibility of setting up a cooperative among community leaders, extending beyond the already-existing daycare cooperative. Yet, while Colcerámica wanted to formalize everything, the community held informality as the norm. In discussing the project with the community, they identified organizational and administrative strategies that, while informal, could be effective. For Carlos: "we became more relaxed about the issue of formalization when we had more contact with people. I met a woman who managed a lending chain for years; she managed a lot of money and everyone had confidence in her. There weren't any papers nor contracts."

After six months of work, Haidy and Carlos held a community meeting to present the model. According to Haidy, "It was the moment of truth: they challenged us for proposing cooperatives. The community said that if they already had their organizations, why should we create new ones?" Carlos recalls, "After hearing the community leaders I asked myself, who are the experts here? We hadn't recognized the real value of the contribution from the community. We had been cocky, and we needed to be more humble." The meeting also served to identify other interests of the participants that could be contrary to those of Colcerámica. For example, one attendee expressed the following: "Two years into this and I'll get to be elected to the city council." The team concluded, "In order for this to work we need to find an intermediary point between being naive and arrogant."

After the meeting, Carlos and Haidy defined the elements of the model: the product, easy financing, communications, community participation and custom design. They also decided to use existing networks in the community. With community's input, they named the project "Your House Made New, Step by Step" and defined a vision: "to provide options to low-income citizens to reach the personal dream of improving their homes through collective support, to commercialize ceramic tiles and to improve the quality of life of communities." Furthermore, something more than tiling would remain in the community: strengthened management skills in their organizations.

Women only were chosen to be promoters for three reasons: they were more sensitive to the idea of home improvement, they had the time necessary to carry out the sales work, and they encountered less resistance when they offered products door to door (e.g. "issues of suspicions and jealousies"). Their responsibilities included visiting clients, advising them, measuring spaces and quoting the price of products, closing the sale and following up on payments. The women had a good sales argument: "Who doesn't want their house to look nice?"

The income for the sales promoter was 7% of sales and it was estimated to reach, on average, US $94 per month. In December 2005, the first group of promoters visited the factory where Ibérica was produced. There they became convinced that the product was indeed new, produced for their community, and that it was not in fact leftover materials from other production lines.

To structure the "Your House" program, community organizations (COs) were selected that could manage promoters (including their selection, support, supervision and payment, under criteria defined by the company), administer money from sales and exhibit the products. Each CO received a 3% commission on sales. The first group consisted of three local city council associations (*Juntas de Acción Comunal*) and one Community Mothers association. On December 19, 2005, these four organizations in Usme, together with seven promoters, began sales using a database of prospective clients that had been collected during promotional events in the community.

While the selling hurdles were just beginning, other internal adjustments had to be implemented. For example, procedures that had been established to pay all of Colcerámica's suppliers had to be changed. For the ISC outlet, the promoters provided a service for which they should be paid in cash every two weeks. Colcerámica was accustomed to pay its suppliers by check or transfers to bank accounts in periods of 30, 60 or 90 days.

Initial operation based on internal adjustments and the creation of an ecosystem

Much had changed within Colcerámica to launch the Ibérica line and sell it through a group of community promoters; and a great deal of organization had happened beyond Colcerámica's boundaries. The first sales came after the company had a product line to offer and after it had taken its time to design with a specific community how to make its offer available.

The promoters delivered concrete business orders to the community organizations, which in turn passed on the orders to the factory. During the following six months, sales doubled those from the previous month. In the beginning of “Your House”, the monthly demand of materials from the COs (an average of 760 square meters) was a decisive factor for Colcerámica as it determined how to deliver the products to clients. When it received an order, the factory generated a purchase order from one of the Ibérica distributors in the area. The high capacity of the factory didn’t allow it to respond directly, since the orders weren’t sufficiently large enough to program an independent run. And since the roads in the outskirts of Usme were narrow and unpaved, the large trucks that were part of Colcerámica’s fleet could not be used for delivery.

Distributors received 6% of the purchase price from the factory. Once the factory sent the delivery order to the distributor, the client could pick up the product at the distributor’s point of sales. Each distributor managed its own factory orders independently, based on its own sales. “Your House” would function under this scheme of distribution and inventory control. Investment in logistical aspects was basic and if the program didn’t succeed, Colcerámica could abandon it with minimum loss and without reducing sales of the Ibérica line.

At first, Colcerámica did not issue credit to clients; it did, however, freeze the price of the product from the moment a client began to make payments, but it only delivered the product once the product had been fully paid. Nor did the company, or anyone under its control, interact with the client. Colcerámica offered a lot of flexibility to its community clients, both in terms of forms of payment as well as product. Soon, Colcerámica agreed to give Community Mothers credit and to deliver the product when 50% of payments had been made, since this group had fixed incomes that made them more prone to pay their monthly quotas.

In the first semester of 2006, “Your House” went from being a pilot project to becoming a company program in the Marketing Area. Until that point, the costs of the pilot had reached $40,900. In March of that year, the Usme Service Center was created with the objective of supporting the work of promoters and the COs, and to generate confidence among people. The company wanted to show the population that it supported the program and that it had a physical presence in the area; people could go and see the products even though purchases should be made through a promoter. The idea was that the Service Center would also become the place where training in handling and installation of ceramic products took place. An employee was transferred there as a Service Center Auxiliary and two others worked as Sales Coordinators, responsible for accompanying promoters and COs. At the time, the team at Colcerámica had constructed, together with the COs and the promoters, a manual called Associative Norms to regulate interactions. The rights and obligations of COs and Colcerámica were defined there.

Soon after, financing became a critical element. Different forms of financing were considered, among them small consumer credits. Because of the difficulty in access to these credits, and thanks to the newly acquired knowledge of the market, management of the tiles company approved extending credits to all clients once they had paid for 50% of their materials. Managing Director Reinaldo Aragón did not place a maximum amount on these credits, but he established that they would cease financing when unpaid credits reached 1% of those issued: "with this population, if you take care not to exceed [clients'] payment capacity, the credit risk remains low; people are willing to pay and they pay."

Towards the end of 2006, greater access to credits resulted in the triplication of sales from previous months. During the first five months of the year, the promoters had sold $16,500 worth of products; and the program closed the year with total sales of nearly $88,400, including sales through the Service Center that had recently been opened in the Agua Blanca district in Cali. The experiences of the communities in Usme differed from those of Agua Blanca. As one promoter in Usme pointed out, "thanks to the work with Colcerámica in our organizations and communities, new ties were created and capacities were developed through training and administration of the program." Although the promoters in Cali also recognized gains, the social entrepreneur who coordinated work with COs there said, "when it came to Cali, the model was already set up; there was less joint construction than there was in Usme and, as a consequence, the company had more control."

The sales outcomes and the payment behavior of clients in the pilot phase showed the "Your House" program's growth potential. The majority of clients finished paying off materials in 8 months, rather than the foreseen 12 months; and 23% of clients in 2006 began new projects in their homes (i.e. return clients). As the program grew, more organizational adjustments were required.

Growth of the Program

In 2007, the "Your House" program was structured as a new sales outlet for the Ibérica brand. The name of the program, "Your House Made New, Step by Step," was maintained for communities and the company called the sales outlets Ibérica Service Centers (ISCs). These centers were administered jointly by sales and marketing; the former had the responsibility over levels of sales and the latter was in charge of making strategic decisions. Adjustments were necessary in different areas of the organization. For example, within the ISCs it was necessary to guarantee the delivery of a uniform product for a minimum of three years, whereas traditionally the product was taken off the market after just two years.

Diego Ángel, who was named Chief the ISC outlets, organized the sales coordinators according to zones, defined a sales objective in each and made coordinators responsible for the sales performance of promoters. Any problems in the interaction with the community, in the COs or in daily operations were taken up by the ISCs. The centers collaborated with the promotion and the organization of orders; they provided an institutional presence, despite being far from the more removed neighborhoods. Clients could see product samples there, not having to depend solely on traditional catalogues, and could get information about probable delivery dates and existing mechanisms of finance.

The ISC grouped together the orders from different promoters, which were done via COs, and the factory could better plan its production and delivery of greater volumes. The increase in sales generated orders of larger volume of certain product references, but those references that did not reach a minimum volume to be produced independently, had to be collected by the plant from excess production of other orders. In these cases the turnover for orders took longer than traditional distributors, but ISCs were informed.

Ángel also considered specific plans to expand the production capacity of the Ibérica brand. Colcerámica had attracted the attention of a variety of players for its model directed at low-income populations. For example, the company received an offer from the InterAmerican Development Bank to finance a new oven that would allow the company to double its capacity. The offer caused concern for several directors, who questioned the risks of having made the model public and given it visibility before assuring its sustainability.

As sales grew, Colcerámica tackled the issue of developing the distribution chain to respond to the growth of the model. A great difficulty was that Ibérica's strategy had been developed along the lines of "delivering the product and nothing more", and the distributor had been considered as the client. The company had repurchased from distributors during 2007, in spite of the overhead costs that this implied, and delivered to them using large 15-ton trucks. The discussion about how to deliver the product close to consumers' homes required convincing the Logistics Department, among others, that it was possible to do things differently. The final distributor was eventually discarded to reduce costs and pursue a profit margin similar to that generated by Ibérica in other channels.

Colcerámica started to invest in expanding the ISCs in each location by using a smaller transportation system to get the product there. The ISCs assumed the role that the distributor previously played, but as part of Colcerámica. Since customers had not opposed picking up the product at the point of sales of the distributor, getting to the ISC, located in the same neighborhood, did not inconvenience them. Given that communities were already familiar with the company, in a period of about two years the ISCs could even sell directly to the community. Each ISC would administer its own inventory, plan its own requirements for future periods, place orders with the factory and receive them without intermediaries.

As the expanded ISCs managed inventory, they needed specialized personnel and machinery, as well as larger storage facilities. Within Colcerámica this meant another shift; as inventory control became more decentralized, it could become obsolete if it was not adequately managed. Good demand estimates and coordinated efforts with COs were the keys to high inventory turnover, so they could keep product lines going for three years; and the larger ISCs could anticipate the need for some orders before production of the reference ended. While the scheme implied investments in larger ISCs, and probably the quantity of references had to be diminished, these changes would result in shorter delivery time. By strengthening its ISCs, Colcerámica attempted to resolve once and for all the problem that it would have when "Your House" reached 36 cities; although the solution would take time, would require greater investments and could risk "cannibalizing the market" with traditional distributors.

As the discussion around distribution issues to achieve greater scale waned, dilemmas about other aspects of the program took center stage. One of them had to do with the working relationship with sales promoters. Some financial modeling gave the company assurance that if they needed to hire them, the program could still be economically viable. However, the preferred option was to help promoters create their own cooperatives.

On another front, there were a number of difficulties in the development of the ISCs; one main issue was that of financing. At the end of 2007, “Your House” had loaned $700,000, of which Colcerámica financed 96%. To work with other financiers, according to Ángel, “would have been more difficult and slower than what was budgeted.” For the financial area of the company, this situation was a latent risk since working with these communities was notably informal and because providing credit was not its line of business.

In December of 2007, ISC outlets had achieved and even surpassed sales forecasts. In one year ISC outlets were opened in 13 localities in five cities (Bogotá, Cali, Medellín, Cartagena and Barranquilla), with a direct sales team consisting of 183 promoters bringing 2,300 families into the program. The Ibérica brand sold 134,000 square meters in addition to the 14 million square meters sold through other channels during the year. According to more optimistic projections, by 2010 “Your House” would sell 1 million square meters monthly and would have an oven with the capacity to produce 1.5 million square meters per month.

In Usme, Colcerámica sold 20,000 square meters of Ibérica products during 2007, but the potential sales according to the company were 45,000 square meters monthly. However, working dynamics of COs take much more time than traditional commercial dynamics. This was a big consideration for the goals that were established; to fulfill them meant opening an ISC every two months and beginning sales two months later. However, growth for the tiling business was on its way; and the experience had opened avenues for the company to think about new markets for its faucets and porcelain toilets and sinks. An encouraging sign came from community leaders who asked the company for offerings of these products that would suit them. They surely appreciated the Ibérica line and they were willing to make more home improvements if Colcerámica offered them a good deal.

Coming full circle

From the start of Colcerámica’s explorations with low-income citizens, the company struggled to reconcile the “formal” world of conventional business with “informal” practices common to communities. These efforts entailed the parallel creation of a new business model and an ecosystem for it to thrive in. The design and development of a new product was the starting point. Several changes to the logistics systems came later; billing, paying and distribution systems were adjusted to a different way of doing business with citizens who had not been in Colcerámica’s radar in the past.

The input for a number of changes in Colcerámica’s systems came from community members. The partnerships that have been established do not rely on a formal contract and the company has given up, to its advantage and that of others, part of the control it used to have. Colcerámica and its partners have created the conditions for “Your House” to flourish, no small feat where a climate of distrust between companies and low-income citizens prevails.

The socially inclusive strategic network that has been created includes heterogeneous parties who share responsibility for performance outcomes and are aligned by incentives that generate win-win relationships. "Your House" is inserted within the core value chain of Colcerámica and it is of central importance to the social entrepreneur who mediates between company and communities, to COs, to sales promoters and to consumers. The established collaborative arrangements allowed Colcerámica to create a new market by leveraging the existing social infrastructure and expert field knowledge, and by externalizing some of the costs of doing so.

A lot of positive changes in the lives of promoters and among the families who bought the products have been witnessed. Community organizations are building capacities along the way. Economic and social aspects have changed for the better, and quality of life has improved.

Since March 2006, Ana Delia Ibarra has participated in "Your House" both as a promoter and as a client. As a promoter, she brought in 37 Community Mothers who like herself, faced pressure from the health department to raise their hygienic standards through tiling. With the proper renovations achieved as a result of the program, the daycare centers continued to serve 481 children. For Ana, this meant nearly doubling her income. As a client she finished tiling her kitchen and continued with her bathroom. According to Ana, "We have benefited from all of it… training, development of values; one becomes enriched as a person and learns many new things."

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PRIVATE SECTOR INVOLVEMENT IN SLUM UPGRADING

Judy L. Baker and Kim McClain

I. Introduction and Background

Living conditions in poor urban slums, characterized by a lack of basic public services and infrastructure, precarious housing, overcrowding and often escalating social problems, remain a major and growing challenge in cities all over the developing world. It is now estimated that one in three city dwellers, a billion people, a sixth of the world's population, live in slums.[1] Governments and the development community have invested significantly in improving the lives of slums dwellers through a range of upgrading programs which typically include infrastructure investments (water and sanitation, waste management, electricity, roads), and in some cases interventions aimed at improving tenure security, social infrastructure, housing quality, access to credit and access to social programs. The immense and growing scale of slums has, however, outpaced the impact these programs alone can have. When considering the scaling up of such efforts to address the growing problem, it is clear that the public sector cannot do it alone and there is much need for alternative approaches. One such approach with enormous potential is the mobilization of additional private sector finance and expertise.

Slums are the spontaneous response of the poor to their own needs for shelter in cities. They are essentially a private phenomenon, which responds to market incentives and distortions without extensive government interference. Slums form part of the informal economy, and they house many of the informal economy's actors. Slums thrive and grow because a significant amount of economic activity contributes to the provision of basic shelter, water, food, energy, and other goods to slum dwellers. Slum dwellers are often entrepreneurs themselves, but their demand also attracts other informal entrepreneurs. For example, so-called "illegal land developers" ignore zoning codes, minimum service requirements for residential subdivisions, (and in some cases even the property rights of the land holder) to sell small un-serviced plots on vacant land, often at the urban periphery, to the urban poor and new migrants. While not a legal business, the process by which these illegal subdivisions allocate land, as in many other types of slums, is entirely market-based with prices that respond to the level of land security, location, proximity to transport and employment, and the size and quality of the plot itself.[2] In slums that have not received assistance from NGOs or the government, the informal private sector has likely been the exclusive means for development, highlighting the market system on which slums rely, the basis for envisioning an expanded role for the formal private sector.

The formal private sector has played a role in slum creation as well as the role of injured party, defendant of property rights, or passive landlord. Private landowners may even be complicit with the "land invasions" and "informal land developers" that establish slums on their property because it opens the opportunity to charge rent to inhabitants while legally reserving the right to evict squatters when better opportunities for commercial development arise.[3]

In general, the formal private sector's attitude toward slums has ranged from indifferent to quietly supportive, primarily because slums house the informal economy which provides goods, services and labor at low costs.[4] The relationship between slum dwellers and business interests has, however, been strained and even contentious at times.[5] Slum creation accelerates with migration and can encroach upon land that is wanted for commercial development. The many negative externalities associated with slums, such as crime, disease, and poverty, can also spill out of the slums into the larger city, affecting businesses directly and the city's image.[6] The private sector's interests regarding slums are not clear cut or homogenous, thus understanding them within the local context is important to approaching and negotiating programs with the private sector.

This excerpt is from a more extensive paper on private sector involvement in slum upgrading. The two sections included here explore the challenges and opportunities for scaling up private participation in urban upgrading activities and the models through which this can happen. Other sections of the full paper also cover current approaches drawing on specific field examples and some of the more innovative solutions both the private sector and its partners have developed, as well as some of the issues and challenges that complicate the private sector's active involvement in slum upgrading within different contexts.[7] A final section looks at opportunities for working with the private sector in scaling up slum upgrading initiatives.

II. Challenges and opportunities facing the private sector in engaging with low income urban areas

The wide array of relationships the private sector has had to slum upgrading and the many innovative mechanisms that have been piloted to encourage these can be described as a mélange of diverse responses to the many different contexts in which slums exist. There are a number of challenges and opportunities in working in low income areas which have been addressed in many different ways. Key issues include the environment for private sector activity, some of the main barriers facing the private sector, as well as the opportunities for both private sector and slums to benefit from engagement.

Economic environment and the state of the private sector

The state of the economy will have a tremendous impact on how the private sector can be mobilized for slum upgrading. A booming economy may attract private finance towards higher yield investments and away from lower yield investments in slums. It may also provide opportunities, however, to harness the demand for high-end real estate development to cross-subsidize affordable housing, as through TDRs.[8] To the extent that economic growth is effectively converted into greater tax revenue, it can also improve the chances that municipal governments' will be able to attract private finance for slum upgrading projects.

The economy will also influence the profile of slums and slum dwellers. The size, shape, and growth of slums depends not only on housing and land markets, but also on migration to cities, the informal sector, and unemployment rates, which are in turn shaped by economic growth. The levels of poverty within a slum are critical to the strategies employed to involve the private sector, and the economic state of the city will largely determine the opportunities for income available to slum dwellers.[9] This is by far the largest factor in spontaneous slum upgrading carried out by the residents themselves, and so it will certainly impact how interested slum dwellers are in cooperating with private sector for improvements.

The state of the private sector itself is also critical. In many countries the formal private sector is relatively small and may have limited capacity and even more limited resources, and is often highly risk averse making it easier to focus investment opportunities with the wealthy. The depth and capacity of the formal financial sector to mobilize capital is an even greater problem. While the informal sector is also a private source of slum upgrading activities, it may not bring to the slums the benefits of economies of scale, investment capital, long run corporate accountability, and integration of the slum into the greater city that are normally pursued with private sector partnerships. The formal private sector may be severely limited in its demand for investment opportunities and as such will not respond as enthusiastically as hoped to opportunities in slums.[10]

Barriers to private sector engagement

The private sector faces a number of barriers and disincentives to targeting the low-income market or engaging with efforts to upgrade slums. Often the choice not to pursue low-income clients or entry into slum markets is a very rational one considering the business, political, and economic structure and environment. Businesses are often ill-prepared to service the low-income market, and their lack of experience with poor clients makes them even more wary of exploring profit-making opportunities in the slums.

Traditional Business Models. The corporate culture in many developing countries does not foster collaboration with or service to the lower-income segment of the population.[11] The predominant business model tends to pursue low volume, high profit margin markets as the key to business success. Low volumes are believed to imply fewer administrative costs, but they must be accompanied with substantial profit margins. High profit margins are more acceptable to consumers at higher income levels. Corporations also often have trouble with pricing structures that stray from a basic unit-pricing scheme, making the transition to differential pricing, which can make servicing low-income clients profitable, more difficult. Internal corporate policies also can get in the way of servicing poor clients. The most common policy to impact slum dwellers is the collateral requirement for loans. Since most slum dwellers do not hold title to their land (and therefore cannot claim secure ownership of any improvements on that land, such as a house or workshop, either), they can present very little collateral and as such are not eligible for loans with formal sector lenders.

Investment Climate. Businesses also respond to national and local business environments, including the financial sector, business laws and regulations, transaction costs, and industry standards, that are often too conservative, costly and idealistic to meet the realities of poor consumers. Laws regarding business contracts, quality standards, labor benefits and wages, building codes, and bookkeeping regulations, among others, increase the cost of doing business in a country and restrict the range of products that can be offered. Poor people's effective demand is often for housing and services that are considered sub-standard by law, thus blocking the formal private sector from providing these products without a special waiver. This is particularly problematic with regard to building codes and the poor's preference for lower-risk, progressive construction of housing.[12] Companies that install infrastructure must present evidence that customers have the right to make changes to the land, which is normally enshrined only in a legal land title. Zoning laws can further restrict how land can be developed by legally barring companies from residential infrastructure installations despite the existence of a community of residential consumers and regardless of the legal title held on the land.[13]

In the financial sector, overly conservative reserve requirements restrict the supply of funds for lending, driving up interest rates, and banking laws often mirror corporate policies by requiring high levels of collateral for all lending.[14] Government regulation of utility prices can also discourage utility companies from investing in the more costly infrastructure required to service slum communities when there is no possibility of charging more to recover the higher costs. Particularly when investment is scarce, business-owners rationally choose to pursue the low-hanging fruit of wealthier markets where business regulations are less of a barrier.

Governments may also have the ability to unilaterally change the terms of contracts with businesses, such as for service provision or as part of public-private partnerships, which can lead to a reluctance of companies to bid on government contracts without substantial measures to mitigate political risk. Lastly, companies are acutely aware of the risk of social unrest in response to changes in service provision, such as the decline of subsidies, the transition from a flat fee to metering, and the removal of illegal service connections.[15] The government's support of companies in these transitions is critical to success and to maintaining the companies' image. Conversely, the government can act opportunistically and prefer the political benefits of siding with the people. While the political environment is more critical in private sector provision of public goods, the government's understanding and support of the private sector and market mechanisms will influence the general public's opinion of businesses and profit-making, and thus shape the relationships companies can build with people.[16]

Public good investments. One of the more fundamental economic problems facing the private sector in contributing to slum upgrading is the fact that many of the goods required by the poor are either purely public goods, or goods with strong positive externalities that create minimal private demand. Streets and pathways, public lighting, rainwater channels, public parks and public security are pure public goods that once supplied, cannot be denied to anyone in the neighborhood (nor to visitors for that matter). Potable water, sewerage, solid waste collection and disposal, electricity, healthcare and public education are goods that can be sold privately to varying degrees, however, denying them to people who are unwilling or unable to pay is not socially desirable because of the positive impact these goods have on the entire community. It is also, to varying degrees, difficult and costly to restrict these services, once installed, to only those who are paying. In both cases, the incentive to free-ride can be strong, making cost-recovery for the company uncertain. In fact, in some slums, the absence of a formal service provider leads slum-dwellers to make illegal connections to nearby electricity, cable television and water networks. Many companies may further interpret poor people's low income as increasing their propensity to free-ride, though there is little evidence to support this suspicion, and private companies are often not willing to risk making an investment when they may not be able to collect payment for their services.[17]

Public goods are often considered the domain of the state, as this is the only institution that can effectively coerce payment for these goods through taxation. States, however, often do not have the capacity to provide all goods deemed to have positive social benefits, the starting point of this work. States do, however, create a political environment around these public and social goods that shape the private sector's willingness to get involved in providing them. States may claim that water, housing, health, and education, among other goods, are basic rights of all citizens, thus making them political issues. When the quantity, quality or price of any of these goods is not in-line with what society considers acceptable, politicians have the incentive to intervene in the market, in the best case, with subsidies and other incentives, and in the worst case (for business), with price controls.[18] In India and Brazil, for example, housing is considered a basic right of all citizens enshrined in the constitution, and politicians have consistently used the provision of free and highly-subsidized housing to win votes.[19] This raises poor people's hope of acquiring free government housing and can decrease their willingness to pay for housing provided through the private sector.

Property rights and land titling. There has been extensive study of the need for recognized and defensible property rights to attract private sector investment.[20] There is a body of literature that considers land titling in slums the most critical intervention that governments can do to spur private investment in slums. Certainly lack of permanent legal title is one of the defining elements of most slums, and it undeniably shapes private investment in housing and neighborhood upgrading, by both households and businesses.[21] The proportion of households with access to secure tenure is in fact the only indicator for the MDG related to improving the lives of people living in slums.[22] There is, however, a considerable gray area between holding a legal title and absolute precariousness, and there is also considerable debate about the true influence of land tenure on willingness to invest.

As most governments have come to recognize the existence of slums and accept them as marginal poor neighborhoods rather than illegal squatter settlements that need to be cleared, slum dwellers have gained differing and fluctuating levels of security of tenure.[23] This security may be informal, but it may be strengthened by pro-poor policies, land being public and without competing owners, historical longevity of the community, low demand for land development and correspondingly low land prices, or other factors that help guarantee that slum dwellers won't be evicted. Some governments also establish semi-formal lease or registration systems, whereby slum dwellers, particularly on public land, make renters' or settlers' arrangements with the government that give temporary legal right to occupy. Street addressing within slums has also been used to give a semblance of official location and recognition to individual homes in slums and normalize the slums as integrated neighborhoods.[24]

The importance of land titling and the extent to which it is a barrier to private sector involvement is a hotly contested issue. Some development professionals believe that it requires excessive time and effort that is only fruitful with significant political will, making it a distraction from the more direct issues of infrastructure and health that slum dwellers more desperately need. On the other side of the debate, the only long term, sustainable strategy is to ensure people have legal title to their land so that private investment can happen spontaneously. A common middle ground is that both land titling and slum upgrading can progress simultaneously, but that neither should be made to wait for the other.

Culture. A final barrier to private sector engagement with the poor is the lack of knowledge and understanding between the two groups. The culture gap between the formal private sector and the urban poor can be significant, making private businesses wary of attracting poor clients and poor people distrustful of private businesses' intentions. Many formal businesses do not see low income customers interested and able to pay for the services they provide. They may fear the crime they hear reported in the slums and believe that they would risk damage or loss of property. The formal business sector historically has had limited experience with poor clients, which impacts its ability to gauge risk, measure demand, and perceive the tastes and desires of the market. In some countries, class stereotypes limit formal business-owners from seeing poor people as a potential market altogether.[25] The misunderstanding and distrust can go both ways, as poor people may perceive formal businesses as exploitative, greedy, and unfair to both customers and workers alike.[26] This may mean that businesses have to invest in building trust with their potential clients in poor neighborhoods before fully perceiving the benefits of entering these markets.

Opportunities for private participation in slum upgrading

Despite the considerable barriers mentioned above, there is a growing awareness of the potential for both slums and businesses to benefit greatly from the engagement of the private sector. The poor, who make up the bottom or base of the economic pyramid (BOP) with less than $3000 in annual income (2002 PPP), total over 4 billion in numbers and over $5 trillion in purchasing power. Hernando de Soto's theory of property rights also proposes that the poor have considerable "dead capital," $1.2 trillion of it according to a 2003 study, in the form of untitled land (slum properties themselves) and unregistered businesses, that can be mobilized through titling and business registration. There is also increasing recognition of the considerable resources generated through remittances that are often channeled into housing and education. In 2005, $167 million in remittances were officially recorded entering developing countries, and as much as 50% more may have been transferred informally.[27] If organized and leveraged correctly, the poor's purchasing power can represent a significant market capable of enticing the private sector into producing goods and services that improve living conditions in slums.

Much of the poor's purchasing power currently fuels the informal economy, and thus represents an un-captured market for the formal private sector. The informal economy produces an estimated average of 30% of official GDP in Asia, 40% in Eastern Europe, and 43% in both Africa and Latin America and the Caribbean making it a substantial proportion of the market.[28] While the informal economy represents an important complement to the formal economy in providing services to the poor, informality can bring with it higher costs of production related to smaller scale, lower quality goods, unsafe and unsanitary practices, exploitative pricing strategies, inconsistency, and other quality and price differentials that disadvantage the poor. This "poverty penalty," as it has been termed, hurts the poor and makes a clear case for encouraging the formal private sector to extend services to the poor. And the fact that the poor do regularly pay a price premium should convince the formal private sector that there is real demand and ability and willingness to pay.[29]

While spontaneous private sector initiatives that benefit the urban poor will continue to happen, there is still a need for public and donor funding and assistance. More importantly, the potential for donor funding to mobilize even greater amounts of private capital is an opportunity that must be recognized. Some programs to encourage investment by local capital markets and slum households themselves have mobilized upwards of 7 times the program budget in private investment.[30] The multiplier effect created by allowing poor people to contribute their own investment and offering a profit-making opportunity to private investors is a critical force for scaling up slum upgrading efforts.

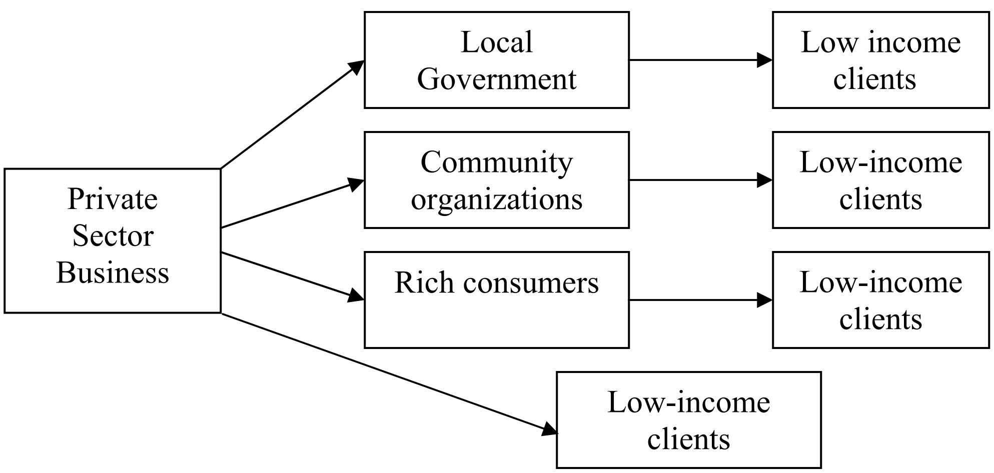
There is much to be gained not only from private sector finance and investment, but also from private sector expertise in efficient management of projects. The private sector has much greater experience in cost-minimization and the effective use of human resources, among many other strategies for efficiency. Formal private economic activity in slums also creates opportunities for wage labor and small local businesses to provide inputs, which lowers unemployment and support entrepreneurs. The presence and participation of the formal sector in slums can help to integrate communities into the broader economy of the city and reverse the marginalization of slum dwellers.[31]

III. Current approaches to private sector participation in slum upgrading

The private sector's role in slum upgrading can take many forms. An attempt to categorize these roles can be done along the lines of who the private sector engages as a client and how that leads to benefits for the poor. These client interactions are categorized as private sector engagement with: i) local government; ii) community organizations; iii) rich consumers, and; iv) directly with the poor. Naturally individual projects and ventures may contain multiple relationships and contracts linking the private sector to the poor, altogether creating a diversity of options for mobilizing private investment. All of these mechanisms direct private investment towards the urban poor and the slum communities they live in, and can result in a wide range of impacts including increased and more efficient service provision, permanent infrastructure, innovative solutions to unique problems of poverty, greater choice for poor consumers, integration of slums into the formal sector and larger city, and social assistance to the poorest slum-dwellers

In the following section, examples of private sector's involvement in slum upgrading are presented according to the kind of business relationship the private sector engaged in, as a way to understand where new projects may involve private sector. The private sector must perceive a profitable transaction with all of its clients, and so understanding how those relationships and contracts have been developed to promote improved welfare for the poor is key to effectively identifying opportunities for private investments in slum upgrading. Beyond the four main categories of client interactions mentioned above, are further links, including patron-beneficiary relationships, political accountability relationships, regulatory relationships, and donor accountability relationships which connect each of these clients to poor people themselves, and can shape private sectors incentives, investments, service quality, and other business decisions. This multiplicity of potential connections creates a diverse universe of potential private-public-individual partnerships, a selection of which is presented below.

Client relationship **Beneficiary relationship**



Local government's mobilization of private finance

Decentralization has increasingly empowered local government to act independently on matters of local development, including efforts to upgrade slums. Resource and capacity constraints, however, remain major challenges and create demand for finance and expertise in the operation and implementation of public works and services. While often bundled with public-private partnership projects that impact the city at large, there are a number of examples where such activities are also financing slum upgrading and service provision to poor areas. Donors such as USAID have created finance facilities, such as the Community Water and Sanitation Facility (CWSF), that provide gap funding and credit guarantees to help municipalities access commercial finance for slum infrastructure and service expansion projects.[32]

Interest has also been growing in municipal bonds as a means to mobilize private domestic capital for public projects. In India, the Ahmedabad Municipal Corporation issued the first municipal bond in 1998 without a central government guarantee for the purpose of financing a city-wide water and sanitation project that included many slum areas and the Slum Networking Project "Parivartan." In 2005, municipal governments around Bangalore built on Ahmedabad's success with a bond issue called the Greater Bangalore Water and Sanitation Pooled Facility that combined the commitments of 8 city governments. In both cases, the success of the bond sales depended on the municipal governments' having previously demonstrated a revenue surplus and received a sufficiently high credit-rating to ensure an interest rate in line with the government's projections of future ability to pay, among other conditions. The ability of municipal governments to mobilize domestic capital greatly enhances the scale at which municipal governments can engage in development. Ahmedabad's four municipal bond issues raised $89.5 million between 1998 and 2006. The Greater Bangalore Facility raised over $23 million with the assistance of a $780,000 partial credit guarantee from USAID, essentially mobilizing over $29 in domestic capital for every dollar donated.[33]

The private sector can also be brought into project implementation and service delivery through contracts and partnerships with local government. Municipal governments that lack the capacity to expand public services can pursue a range of public-private partnerships. Table 1 lays out the basic characteristics of the main types of public-private partnerships for infrastructure.

Table 1: Types of Private-Public Partnerships

Option	**Asset ownership**	**Operations and maintenance**	**Capital investment**	**Commercial risk**	**Duration**
Service contract	Public	Public and private	Public	Public	1-2 years
Management contract	Public	Private	Public	Public	3-5 years
Lease	Public	Private	Public	Shared	8-15 years
Concession	Public	Private	Private	Private	25-30 years
BOT/ BOO*	Private and public	Private	Private	Private	20-30 years
Divesture	Private or private and public	Private	Private	Private	Indefinite (may be limited by license)

* Build-operate-transfer/ build-operate-own

Source: "Selecting an Option for Private Sector Participation," World Bank Toolkit, 1997.

The experience with public-private-partnerships in urban slums has mainly been through components of larger projects that may include an entire utility (water, sewerage, electricity, transport) within a certain city or region. Municipal governments may hire a private company to extend the water and sanitation network to new parts of the city including slum communities (a service contract), or they may include in a concession the commitment to extend service to certain slum communities, which obliges the private company to recover the costs of service provision and initial investment from their customers, including the slum dwellers. Pilot projects to extend service to poor communities in Jakarta as part of two separate water concessions have had some success, although moving beyond the pilot phase has been difficult. In Port Vila, Vanuatu, a concession contract successfully extended free potable water service to poor areas through cross subsidies from wealthier areas. In Manila, the concessionaires Mayniland Water Services and Manila Water Company use a variety of internal programs and partnerships with NGOs, community organizations and small entrepreneurs to increase water distribution to slums.[34] Municipalities have discovered that involving the private sector in public utilities and works is not without its problems, but as cities continue to consider public-private partnerships as ways to improve public services, service expansion to slums can be brought to the negotiating table and integrated into PPP contracts.[35]

Output-based aid (OBA) is a growing trend in structuring subsidies to the private sector so as to ensure that performance targets, particularly those related to service provision to the poor, are met. OBA links the payment of subsidies to the demonstration of specific service delivery or outputs, such as the connection of a set number of new customers to the electrical grid or water distribution network. Private providers must therefore shoulder their own risk of non-performance and provide their own finance upfront (in most cases) to meet the performance targets.[36] OBA has been particularly effective in extending water connections to slums through one-time network extension and connection fee subsidies, such as is being done in Manaus (Brazil), Jakarta, Manila, Mozambique, Surabaya (Indonesia), and Ethiopia.[37] As with concessions and other public-private partnerships and contracts, sufficient attention must be paid to mitigating payment risk on the part of the government and to designing efficient and credible monitoring and administration systems.[38]

Communities as clients

When slum dwellers are locally organized into community organizations or town councils, and particularly when they can ally themselves with local NGOs, there is an opportunity for their collective organization to attract the attention of the private sector and convince private business and investment of their collective potential as a client. Like local governments, local community based organizations (CBOs) and NGOs can organize and partner with the private sector to acquire goods and services that can then be enjoyed by all slum dwellers. The Community-Led Infrastructure Finance Facility (CLIFF) bases its model on the idea that local community organizations are capable of attracting private finance for their slum upgrading activities in the same way municipal governments can. The CLIFF provides grants for technical assistance, capital, knowledge-sharing, and management costs in additional to facilitating credit guarantees for local organizations that are soliciting private and public finance in order to scale up local solutions to the problems in slums. The Indian Alliance, a local NGO, has been able to get financing for housing projects for slum dwellers from domestic banks with only a 10% guarantee from CLIFF (down from an over 100% guarantee 10 years ago).[39] UN-Habitat has piloted a similar finance facility, the Slum Upgrading Facility (SUF), which looks to organize public, private and community stakeholders to encourage involvement of all sectors in enabling community organizations to carry out bankable slum upgrading projects.[40]

Box 1: Getting Private Water Utilities into Slums: Metro Manila Water Concessions

Metro Manila's water authority was privatized in 1997 with the intention of solving problems of inefficiency and financial shortfalls. Two 25-year concession contracts were signed, one with Manila Water Company (composed of Ayala and International Water) to cover the eastern zone of the city and a second with Maynilad Water Services (Benpres and Ondeo) to cover the western zone. Both concessionaires are required to expand service coverage to 77-87% by 2001 and 95-98% by 2021. To achieve this, both companies have had to devise strategies to profitably extend water services to slums.

Although the concession agreement allows for the installation of one public standpipe per 475 people in depressed areas, both companies have worked to establish other types of connections that bring water closer to people's homes and ensure greater revenue for the companies. Manila Water has introduced group taps for 2-5 households to share a single connection registration and water bill. The company has also introduced community-managed water connections in which a community association is responsible for a master meter and installs and manages a distribution network to blocks or individuals. Manila Water also permits private companies to buy water for resale through private distribution networks, which the contractor must take responsibility for maintaining.

Maynilad has actively sought out partnerships with NGOs to extend individual household connections, preferred by customers in all income groups, to slums. Its Bayan Tubig (Water for the Community) program waives the land-title requirement in slums and integrates payment of the connection fee into the first 6, 12, or 24 monthly water bills. NGOs, such as the Swiss chapter of Médecins San Frontières and the local LINGAP Foundation in Malabon, get communities involved to support ownership of the program through information, education and community campaigns and assistance to the poorest families through microfinance. Maynilad additionally will contract with community-based associations to provide billing and collection services, which further localizes value creation in household water provision.

The companies have enhanced their image and have decreased non-revenue water through formalizing water provision arrangements in slums where many people had been receiving water through illegal connections and public standpipes. Through their contract with the local government and their partnerships with NGOs and community associations, these two private water utilities are promoting access to safe, reliable potable water in the poorest areas in Metro Manila.

From Almud Weitz and Richard Franceys eds., *Beyond Boundaries: Extending Services to the*

Urban Poor, Asian Development Bank, August 2002, http://www.adb.org/documents/books/beyond_boundaries/beyond_boundaries.pdf, pp. 56-60. See also, Richard Franceys and Almud Weitz, "Public-Private Community Partnerships in Infrastructure for the Poor," *Journal of International Development* 15, 2003, p. 1092-1094.

Communities can also organize to acquire other services from the private providers who may be unprepared to market their services to individual consumers in slum neighborhoods. In Port Vila, Vanuatu, a private company provides solid waste collection services to many areas of the city and recently began collecting from numerous centrally located points in the peri-urban village of Mele. The company began service in response to the village's collective request for a contract, and continues to deal with the village collectively through a health management committee that selects the pick-up sites, collects donations, and pays the company.[41] Community water boards are also a common way for poor neighborhoods to convince water utilities to provide service, as the community assumes the responsibility for collecting fees from users (often by applying flat fees per house, apartment, or business instead of metering charges which requires greater capital investment) and paying the monthly bill.[42]

In microfinance for housing, effective NGO microlenders can mobilize the credit histories of their member/borrowers in order to access commercial lines of credit and therefore expand their pool of funding. Genesis Empresarial, a Guatemalan NGO working in rural microenterprise and housing lending for the poor, is an example of an NGO that has gained access to credit lines from commercial banks, which they then extend to their clients on a cost-recovery and even profitable basis.[43]

Lastly, when pursuing title to their land, often the only viable option for poor slum-dwellers is to negotiate collectively, particularly when land must be purchased from and financed by the private sector. One such example is Terra Nova, a Brazilian for-profit company that regularizes land that has been illegally occupied by negotiating a fair price between the owners and residents, buying the land, making improvements on it, and then immediately reselling it to the residents at the collectively negotiated price. The organized collective bargaining keeps owners and the company in check from pricing the land above what the residents can pay. [44]

Harnessing the private sector's pursuit of high-end markets

Traditionally private businesses have focused on the higher-income market for the bulk of their profits because of the high profit margins this market permits and the higher perceived potential for growth. This profit-seeking tendency towards higher-income consumers can actually be harnessed to extend benefits to the poor through government regulatory instruments and even activism with higher-income consumers. The most common way private sector's focus on the high-end market is shaped to benefit the poor is through regulation of tariff structures to create cross-subsidization. This is often seen where water and sanitation utilities have been integrated with the private sector. Tariffs can be set by zones to benefit poor slums or by consumption levels, which set lower rates for a basic level of consumption (often termed a lifeline block) and then increasing rates for higher levels of consumption.[45] The type of price setting allows producers to lower the price for those who won't buy at higher prices, and therefore expand sales without losing the revenue from higher prices applied to those who are willing to pay more. The privatization of public utilities has its own difficulties, but integrating such cross-subsidization of service expansion to the urban poor in the contract conditions private companies' pursuit of the high-income market on its extension into the low-income market as well.

Innovative land-use management techniques have also used this approach to engage private developers in low-income housing and slum upgrading. In US cities, mixed housing development regulations have been used to oblige developers to produce and offer a certain number of units within each newly developed neighborhood at prices that are affordable to low-income households. In addition to producing housing for poor families, it also has the added benefit of avoiding exclusively low-income neighborhoods by integrating different levels of housing within one new development.[46] In the developing world, the creation of "Transferable Development Rights" (TDRs) has brought developers into the low-income market in much the same way. In Mumbai, developers were offered an increase in the permitted floor-surface-index (FSI) if they agreed to produce a given number of low-income units. In cases of slums, the government would require the developer to provide serviced housing *in situ* for all families in the slum, although the slum could and would be densified, but would allow the developer to take any remaining FSI and use it to develop market-rate apartments or commercial units on the same site, or transfer the FSI as TDRs to another location or sell them to another developer for use elsewhere in the city.[47] Developers responded not to the opportunity to upgrade slums or produce low-income housing, but to the opportunity to pursue more high-income development.

Even in cases where government was not involved, slum communities have come to similar arrangements with developers that owned the land where slums were situated but faced long court battles to evict slum dwellers. In an arrangement called "land-sharing," communities agree to voluntarily vacate part of the land for commercial development in return for receiving rights to occupy, and in some cases even housing and basic services, on the less commercially-viable part of the land. Examples include Thailand, the Philippines, Cambodia and India.[48]

While corporate social responsibility is not necessarily the private sector's most sustainable solution to the problems of urban poverty, it is worth mentioning that companies are increasingly recognizing the marketing power of philanthropy, particularly among higher-income consumers. Just as "green products" are taking over the high-end marketplace, socially responsible practices, such as fair wages and giving back to local communities, are increasingly publicized to attract greater brand loyalty from higher-income consumers. Activism directed at companies and their preferred consumers can bring awareness to the needs of the poorest people in slums, and contribute to greater corporate responsibility and philanthropy for housing, health and education services for the poorest of slum dwellers.

Direct marketing to the poor

While the urban poor undoubtedly struggle daily with limited resources, they do rely on the cash economy to purchase most of what they need to survive. The formal private sector often discounts the profitability of marketing to the poor, but the growth of the informal sector, which does target primarily the poor, is evidence of the buying power of slum dwellers. There are numerous examples of private sector innovation and market expansion directed towards what is increasingly referred to as the "bottom of the pyramid." Many of these are also examples of private sector engagement improving the quality of life in urban slums.

The private sector is particularly suited to housing markets, a principal private good in slums. Non-profit microfinance institutions are converting into for-profit lenders,[49] and private commercial banks are beginning to show interest in extending lines of credit to housing microfinance lenders.[50] Loans are made available for progressive housing construction, substitutes are made for collateral requirements including a shift away from mortgage finance in favor of other forms of guarantees such as group lending, and loans are bundled with savings and insurance services to help mitigate risks for both the bank and the poor household.[51]

Financial services are critical to the urban poor, who are more integrated into the cash economy than the rural poor and yet face many of the same barriers to accessing financial institutions. Carrying cash after payday or to make a large payment also puts people at risk of robbery.[52] In the Philippines, Smart Communications and Globe Telecom have created cell phone based financial services that allow users to pay for goods, transfer money and cross-border remittances, purchase airtime, pay utility bills and perform other financial transactions with the use of text-messages. Globe Telecom's systems do not even require the user to open a formal bank account, rather it allows transactions through partnered retail locations in addition to banks. The South African Bank of Athens has created a virtual bank called "Wizzit" that gives its customers a debit card and facilitates a number of transactions through secure mobile phone systems and existing worldwide ATM networks.[53]

Cemex, the leading Mexican cement producer, has gotten even more directly involved in housing construction by targeting its Patrimonio Hoy program to low and middle income families that are building their homes one room at a time. Cemex allows households to sign on to a 70 week program in which they make weekly payments in return for scheduled deliveries of cement at key intervals in the construction process. The price is locked in the day the household signs up, and technical assistance is available as part of the club fee charged to all program members. The credit provided for the purchase of cement, plus the technical assistance and storage that is provided to decrease loss of materials, have allowed families to add an additional room in 60% less time and with 35% less expense and of higher technical quality. Patrimonio Hoy has been an entirely commercial venture and gained a strong foothold in the lower to middle income construction market. Its success has led Cemex to extend it to the other countries where the company has operations.[54]

Health and hygiene are also areas that the private sector has introduced products to be marketed to the poor. The poor often buy in small quantities as they have little cash available and are hesitant to commit too much money to any single purchase when their incomes are unpredictable. Sachet packaging of soap, shampoo, and laundry detergent and single dose sales of common painkillers, fever and cold medications are giving poor people easy access to these products that were recently considered luxuries.[55] The lack of health facilities in slums has inspired the development of franchises of pharmacies that provide medical consults with physicians, blood pressure checks, and other health services along with medicines and health products, like condoms, clean syringes and insecticide-treated bednets, in and around slum neighborhoods. Franchisees get the benefit of brand recognition, and are obliged to undergo quality audits to ensure a consistent level of service. The poor have easier access to basic medical advice, and pharmacy doctors and nurses can help recognize when clients should seek further care. CFWshops in Kenya and Mi Farmacita Nacional in Mexico are both successful examples of this model.[56]

As discussed earlier, many of the most basic goods needed to make slums livable are public goods or goods with strong externalities that make individuals less likely to pay their full cost. The private sector does not have strong incentives to produce these goods because they cannot be sure that they will be able to recover their costs from consumers. New innovations in payment for services, however, are helping to alleviate these fears and mobilize private capital and business towards the slums. The Aquacard, a debit card used to turn on a water spigot, can be used by residents to purchase water from a shared faucet without the markup of a local water vendor. The water provider receives payments immediately through agreement with the bank where the water debit accounts are held. Residents get the benefit of access to water and prepayment that eliminates any risk of future unexpected debt, and the water provider has 100% collection of user fees. The *Sulabh* Sanitation Movement provides bathroom and washhouse facilities in slums in India under a similar prepaid system whereby residents can purchase monthly family passes and visitors can pay-per-use.[57] As described in the section on communities as clients, collective responsibility for payment at the community level is also a way to relieve private sector providers of the burden of revenue collection and further induce them to enter markets.

The challenges of service provision to urban slums have inspired a wide range of small-scale solutions by private entrepreneurs whose business models are tailored to fit the unique structure of costs and demand found in particular slum communities. While formal private sector providers may have the advantages of scale and management experience, small-scale providers have the advantages of flexibility in product and process, and in-depth knowledge of specific local contexts. In water, small-scale providers include owners of water tankers, drillers of boreholes, and private venders who distribute water from a standing tank, utility connection or a well through control of a standpipe or through a local distribution network that is privately installed.[58] Small-scale providers in communities without access to the electrical utility grid have used diesel generators to provide energy to locally built networks and even to charge 12-volt batteries for a fee.[59] Entrepreneurs have also provided sanitation services through the emptying of pit latrines, a process that was studied by UN-Habitat in 1996, leading to the introduction of Vacutug, an improved version of private providers' waste-container pushcarts that includes a diesel engine powered vacuum and a 500 liter tank.[60] While each individual venture is usually small, the total capital invested in slums by small-scale providers is not: in Manila, one small-scale water provider invested $350,000 in five years to deliver water to 25,000 households; the small-scale providers in Ho Chi Minh City have invested $80,000 in providing water to 400 household connections.[61]

Small-scale providers have developed a variety of solutions to the needs of slum dwellers for water, sanitation, electricity, telecommunications, and transport that are often second-best options yet optimal under the given circumstances. They can sometimes, however, be the first to introduce and test the pro-poor potential of technological advances, such as internet, computer and cellular technology.[62] Their knowledge of the market, flexibility to try out innovative technologies and business models, and existent capital investment in slums, make small-scale providers an important part of the private sector which has enormous potential in the provision of basic services.[63]

Box 2: Small Water Providers and OBA Strategies: *Aguateros* in Paraguay

Like most Latin American countries, Paraguay's potable water is provided principally by public water utilities—ESSAP in urban areas and SENASA in rural areas—however, a total of 17% of residential water connections are installed and serviced by approximately 400 independent small-scale water providers. These *Aguateros* provide potable water to close to 500,000 mostly poor residents of the peri-urban communities around Asunción and other cities through independent wells and distribution networks servicing 300 to 3,000 households each. *Aguateros* are capitalist entrepreneurs that invest their own funds or borrow from commercial banks to take advantage of the growth in peri-urban neighborhoods by setting up profitable water systems. They have adapted their revenue-raising techniques to match the payment abilities of their clients through market-rate financing of connection fees, and initial flat-fee monthly tariffs before later installing meters.

A working relationship between *Aguateros*, some though not all of whom operate informally, and the government has been negotiated over the 20 years since *Aguateros* began doing business. The public utilities have regulatory power over any water providers, and they review all *Aguateros'* bi-annual water quality certifications. They are also increasingly exerting control over tariffs and fees charged to users in response to some *Aguateros'* acting monopolistically and abusing users. The *Aguateros* have also organized an association to represent their interests, improve their own image and better negotiate with the government.

In 2002, working with the World Bank's Global Partnership on Output Based Aid, SENASA initiated a pilot OBA program to take advantage of *Aguateros*' and small construction companies' entrepreneurialism to provide potable water to four rural villages. Builder-operator consortiums bid for a contract that offered a per-connection subsidy contingent on completion of a borehole, disinfection system, elevated or pressurized ground storage tank, and distribution system with working household connections in each of four communities. SENASA negotiated the terms with local water users associations to ensure agreement on users' connection charges (beyond the subsidy) and tariffs. The response from the communities has been very positive, particularly due to the speed with which the projects were brought to completion, supporting the hope that partnerships between SENASA and *Aguateros* can continue to extend access to water to small towns and peri-urban communities.

The success that small-scale private water providers have had in formalizing their business and engaging with government regulatory agencies effectively deepened the private water sector, and this created the competitive conditions necessary for the success of output-based aid.

From "Aguateros: Small Scale Water Entrepreneurs," *Upgrading Urban Communities: A Resource Framework*, Section: Case Examples, The World Bank Group, http://web.mit.edu/urbanupgrading/upgrading/case-examples/ce-py-agu.html and Franz Drees-Gross et al., "Output-Based Aid in Water: Lessons in Implementation from a Pilot in Paraguay," *OBApproaches* Note Number 7, May 2005, http://www.gpoba.org/docs/OBApproachesParaguaywater.pdf.

Private sector in promoting local economic activity

Many of the strategies companies use to target the low-income market require bringing services closer to where people live and selling them in small quantities at higher volumes. These strategies require manpower within the slums, giving them an added benefit within slum communities – the creation of jobs and income generating opportunities. As companies expand to enter the low-income market, their labor forces must increase, but perhaps most important are the jobs and entrepreneurial opportunities that appear within the slums, and for which slum dwellers are best prepared. Patrimonio Hoy employs local promoters who receive commission for each new group of members that signs onto the program. Franchise pharmacies give slum dwellers with street-front property a lucrative business opportunity. Sulabh washhouses require full-time attendants. In slums where unemployment is truly high, these new sources of income for the poor cannot be overlooked as part of the benefit of private sector engagement.

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[1] United Nations Population Fund (UNFPA), State of the World Population 2007: Unleashing the Potential of Urban Growth, 2007, p. 16.

[2] See, United Nations Human Settlements Programme (UN-Habitat), *The Challenge of Slums: Global Report on Human Settlements 2003*, Sterling, VA: Earthscan, 2003, pp. 105-106 and Erhard Berner, "Learning from informal markets: Innovative approaches to land and housing provision," *Development in Practice* 11:2/3, May 2001, pp. 297-302, for a discussion of illegal sub-divisions and other mechanisms by which slum dwellers purchase or rent their plots.

[3] The case of urban slums in Tegucigalpa is one where ownership is contested between the local government and a number of wealthy landowners who have to varying extents extorted rent out of squatters and ultimately sought payment for the land after it had been developed ("100 millones de lempiras podría obtener Siri Zúñiga por negligencia de Alcaldía en pleito de tierras ejidales," Revistazo.com 6, Jan. 2003, http://www.revistazo.com/ene-03/index.htm). See also Erhard Berner, pp. 297-302, for a more general discussion of landowners' participation in slum creation.

[4] United Nations Human Settlements Programme (UN-Habitat), pp. 67-8.

[5] Harassment and eviction of slum dwellers by authorities can result from the pressure of business interests to open up land for development (Julia Viloria-Williams, *Urban Community Upgrading: Lessons from the Past – Prospects for the Future*, Washington, DC: World Bank Institute, 2006, pp. 2, 9-10).

[6] United Nations Human Settlements Programme (UN-Habitat), pp. 65, see p. 78 (footnote 74) for examples of slum dweller "relocation" for Olympics games.

[7] The full paper is forthcoming, 2008. For information, contact Judy Baker at jbaker2@worldbank.org

[8] A building boom in the 1980s in Bangkok created the development pressure needed to make land sharing agreements appealing to owners of squatted land (Shlomo Angel and

Somsook Boonyabancha, p. 110). Conversely, the fall in property values in Mumbai after 1997 adversely impacted the viability of the government's TDR scheme for slum upgrading (Vinit Mukhija, p. 801).

[9] See United Nations Human Settlements Programme (UN-Habitat), pp. 96-104 for an overview of economic and employment conditions of slum dwellers.

[10] See David S. Olinger, pp. 5-8, for a discussion of the range of characteristics of formal and informal private sectors.

[11] See discussion of the assumptions held by MNCs about the poor in C.K. Prahalad, *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits*, New Jersey: Wharton School Publishing, 2005, p. 8-9.

[12] John F. C. Turner, *Housing by People: Towards autonomy in building environments*, New York: Pantheon Books, 1977.

[13] *Housing: Enabling Markets to Work*, World Bank, Apr. 1993, pp. 24, 28-30.

[14] David L. Painter, "Scaling up Slum Improvement: Engaging Slum Dwellers and the Private Sector to Finance a Better Future," TGCI Development Innovation, June 2006, p. 16.

[15] See Tillmann Sachs and Robert LK Tiong, "The impact of political risks on public-private partnership (PPP) opportunities in Asia," 2005, http://www2.ntu.edu.sg/ResearchPaper/ODR/2006/Impact%20of%20political%20risks%20on%20PPPs%20-%20CEE.pdf.

[16] See C.K. Prahalad's discussion of the Indian government's relationship with the private sector, p. 6-7.

[17] Richard Franceys and Almud Weitz, "Public-Private Community Partnerships in Infrastructure for the Poor," *Journal of International Development* 15, 2003, p. 1084.

[18] Patricia Clarke Annez, "Urban Infrastructure Finance from Private Operators: What Have We Learned from Recent Experience?" World Bank Policy Research Working Paper 4045, Nov. 2006, pp. 10-12.

[19] For Brazil see Jessica Budds, Paulo Teixeira and SEHAB, "Ensuring the right to the city: pro-poor housing, urban development and tenure legalization in Sao Paulo, Brazil," *Environment and Urbanization* 17, 2005, p. 96. For India, see Sundar Burra, "Towards a pro-poor framework for slum upgrading in Mumbai, India," *Environment and Urbanization* 17, 2005, p. 72.

[20] See United United Nations Human Settlements Programme (UN-Habitat), pp. 167-72.

[21] C.K. Prahalad connects the lack of land titles to the poor's preference for holding wealth in durable household items as opposed to immovable land and housing improvements. C.K. Prahalad, p. 12.

[22] "A complete listing of the goals, targets, and indicators for MDGs," World Bank, http://devdata.worldbank.org/gmis/mdg/list_of_goals.htm.

[23] For a full discussion of types of slum formation and tenure, see United Nations Human Settlements Programme, pp. 79-88.

[24] Catherine Farvacque-Vitkovic, Lucien Godin, Hugues Leroux, Florence Verdet, and Roberto Chavez, *Street Addressing and the Management of Cities, Directions in Development*, Washington, DC: World Bank, 2005, pp. 36-39.

[25] C.K. Prahalad, pp. 8-10, 20-1.

[26] Government and charitable organizations have often gone along with the "dominant logic [that]…the private sector [is]…exploitative of the poor" (C.K. Prahalad, pp. 6-7, 9).

[27] *The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid*, World Resources Institute, 2007, p. 16.
[28] Attributed to Friedrich Schneider (2005); quoted from *The Next 4 Billion*, p. 16.
[29] C.K. Prahalad, p. 11-12.
[30] David L. Painter, p. 11.
[31] C.K. Prahalad describes the poor's integration into the formal market economy as providing opportunities for acquiring a formal identity, p. 107.
[32] "Community Water and Sanitation Facility: A Cities Alliance Initiative," Factsheet from the Fourth World Water Forum, Mexico City, March 2006.
[33] David L. Painter, pp. 19-20.
[34] See Almud Weitz and Richard Franceys eds., *Beyond Boundaries: Extending Services to the Urban Poor*, Asian Development Bank, August 2002, http://www.adb.org/documents/books/beyond_boundaries/beyond_boundaries.pdf, pp. 50-61 for further description of these public-private partnerships, and the full publication for a broader selection of examples.
[35] See Almud Weitz and Richard Franceys eds., *Beyond Boundaries: Extending Services to the Urban Poor* for examples of problems with pro-poor concessions. See Meera Mehta, "Balancing Commercial Viability with the Needs of the Poor in the Development of Urban Water Supply and Sewerage Projects," *Project Notes* 14, USAID Indo-US Financial Institutions Reform and Expansion Project – Debt Market Component FIRE(D), January 1999, http://www.niua.org/indiaurbaninfo/fire-D/ProjectNo.14.pdf, for issues related to integrating service provision to the poor into commercially viable projects.
[36] "Output-based aid: Supporting infrastructure delivery through explicit and performance-based subsidies," *OBApproaches* Note Number 5, March 2005, http://www.gpoba.org/documents/OBApproaches_What_is_OBA.pdf, and the GPOBA website: www.gpoba.org.
[37] *GPOBA Activities* (updated Feb. 22, 2008), http://www.gpoba.org/activities/index.asp.
[38] "Output-based aid:…."
[39] Ian Morris, Financial Services Coordinator, Homeless International, telephone interview, March 28, 2008.
[40] Ruth McLeod, "SUF Local Finance Facilities: what they are, why they are important, and how they work," UN-Habitat Slum Upgrading Facility (SUF) Working Paper 8, April 2008.
[41] Almud Weitz and Richard Franceys eds., *Beyond Boundaries*, pp. 42-43.
[42] Juntas Administradoras de Agua (administrative water boards) are the most common mechanism for charging for water and maintaining distribution systems that provide through household connections in poor slums and rural villages in Honduras (Author's experience). Water boards are also used in poor slums in Manila (Richard Franceys and Almud Weitz, "Public-Private Community Partnerships…," p. 1093).
[43] Ivo Imparato and Jeff Ruster, *Slum Upgrading and Participation: Lessons from Latin America*, Washington, DC: World Bank, 2003, p. 284.
[44] See "FIABCI Premia Cohapar e Terra Nova, Do Parana," *FIABCI Brasil Informa*, Apr. 19, 2005, www.fiabcibrasil.com.br/Noticias.asp?CodNoticia=582, and www.grupoterranova.com.br.
[45] "Establishing Pricing Policy," *Water and Sanitation for All: A Practitioners Companion*, http://web.mit.edu/urbanupgrading/waterandsanitation/funding/estab-price-policy.html.

[46] For a complete discussion of mixed-income housing in the US see Alastair Smith, "Mixed Income Housing Developments: Promise and Reality," NeighborWorks Program, Joint Center for Housing Studies of Harvard University, Neighborhood Reinvestment Corporation, October 2002, http://www.jchs.harvard.edu/publications/W02-10_Smith.pdf.
[47] Vinit Mukhija, "Enabling Slum Redevelopment in Mumbai: Policy Paradox in Practice," *Housing Studies* 16:6, 2001, pp.791-806.
[48] Shlomo Angel and Somsook Boonyabancha, "Land Sharing as an Alternative to Eviction: The Bangkok Experience," *Third World Policy Review* 10:2, 1988, pp. 107-127.
[49] Many microfinance institutions have entered the field of housing microfinance: "Cases in point include Banco Sol in Bolivia, Banco Solidario in Ecuador, Mibanco in Peru, Banco Ademi in Dominican Republic, Calpia in Honduras and Genesis Empresarial in Guatemala." (Bruce Ferguson, "Housing microfinance – a key to improving habitat and the sustainability of microfinance institutions," *Small Enterprise Development* 14:1, March 2003, pp. 26-7)
[50] PROA, an NGO working with Aymara and Quechua populations in El Alto Barrio, receives funding for its shelter lending program from Mutual La Paz, a traditional mortgage lender. Loans are for home improvement, water and sewer line connections, titling, and new constructions built by small contractors (David S. Olinger, "The Role of the Private Sector in Delivering Low Income Housing in Developed and Developing Countries," International Housing Coalition, paper prepared for the World Urban Forum III, Vancouver, Canada, June 2006, pp. 23-24). Genesis Empresarial has also received a commercial line of credit from local commercial banks for housing microfinance (Ivo Imparato and Jeff Ruster, p. 284 and www.genesisempresarial.com).
[51] David L. Painter, pp. 11-18.
[52] *The Next 4 Billion*, p. 97.
[53] *The Next 4 Billion*, pp. 102, 104.
[54] See "Combining Profit and Social Development," *Global Envision*, May 27, 2003, www.globalenvision.org/library/5/484 [accessed Feb. 15, 2008], or Ricardo Sandoval, "Block by Block," *Stanford Social Innovation Review,* Summer 2005.
[55] C.K. Prahalad, pp. 16-18.
[56] *The Next 4 Billion*, p. 35, 39-40.
[57] Almud Weitz and Richard Franceys eds., *Beyond Boundaries,* pp. 40-41.
[58] In Cebu, small-scale providers manage small household distribution networks from their own private wells in areas not reached by the public utility. In Delhi, tricycle services can be hired to transport water from a public standpipe to the home. In Dhaka, 9,100 households are provided minimal water through an illegal distribution network that draws water without charge from the public utility network. In Ho Chi Minh City, almost 20% of residents get their water from small providers who resell water from their private connection, operate water tankers, manage small pipe networks, sell bottled water, or in one case, provide well water through a partnership with the public water utility. (Arthur C. McIntosh, *Asian Water Supplies – Reaching the Poor, Asian Development Bank*, London: IWA Publishing, 2003, http://www.adb.org/Documents/Books/Asian_Water_Supplies/asian_water_supplies.pdf)
[59] Yemen has achieved high levels of rural electrification through private networks powered by diesel generators. In parts of Africa, 12-volt batteries are a popular energy source and private generator owners charge to re-charge batteries. (David Ehrhardt, "Impact of Market Structure on Service Options for the Poor," for the conference Infrastructure for Development: Private

Solutions and the Poor, May 31 – June 1, 2000, London, UK, http://www.castalia.fr/SITE_Default/x-files/1863.pdf)

[60] Graham Alabaster and Iole Issaias, "Removing human waste – the Vacutug solution," *Habitat Debate: Water and Sanitation for Cities* 9:3, September 2003, p. 17.

[61] Herve Conan, "Scope and scale of Small Scale Independent Private Water Providers in 8 Asian Cities," http://www.adb.org/Documents/Events/2003/3WWF/conan.pdf, p. 5.

[62] Private internet cafes and village telephone operators are often the first to connect residents to information technology, and their services by necessity often include training and promotion of the various uses of these technologies in order to attract and keep their clients. Small-scale providers and poor consumers alike are generally "more willing to adopt new technologies because they have nothing to forget." (C.K. Prahalad, p. 16)

[63] For a discussion of how to engage small-scale providers, see Marianne Kjellen and Gordon McGranahan, "Informal Water Vendors and the Urban Poor," IIED Human Settlements Discussion Paper Series, March 2006, http://www.iied.org/pubs/pdfs/10529IIED.pdf, pp. 19-23.

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THE MILLENNIUM CITIES INITIATIVE: A COMPREHENSIVE APPROACH TO REDUCING URBAN POVERTY AND GENERATING SUSTAINABLE PROSPERITY

Susan Blaustein

In recent years official development assistance has trended toward sectoral support, filling pressing needs in the domains of public health, water and sanitation, education, or governance. With this approach, donors are able to see and monitor progress in their chosen areas, take pride in a sense of accomplishment, and report these accomplishments back to their constituencies, including taxpayers who, feeling a sharp economic pinch themselves, may be questioning that overseas development assistance should continue to be a national government priority. One unhappy consequence of this explicitly segmented approach is that the notion of the urban region as an integrated organism, requiring a full, coordinated diet of multi-sector interventions to ensure its ongoing economic, social, and environmental health, has faded into the background.

Strangely, and somewhat incoherently, this tendency coincides with the global embrace of the Millennium Development Goals (MDGs), a set of fundamental objectives adopted by the

United Nations and aimed at improving access to such fundamental human rights as health, education, clean water and sanitation, gender equality, environmental protection, and sustainable economic development. As the limited success of even the best sector-focused development projects have revealed, the MDGs can be fully achieved only in concert: if the farmer is unlucky enough to succumb to malaria during the planting season, no matter the improved seeds or fertilizers he has been given, he will not be able to get them into the ground in time for the rainy season. If the elimination of fees and provision of better equipped facilities make it possible for young girls to finish elementary school, but their families then need them to spend their days collecting water rather than attending secondary school, those girls will not achieve their potential either as learners or earners, distinct gender inequality will persist and the much-needed demographic transition to a diminished total fertility rate probably will not occur.

In cities and urban regions, an integrated approach is just as essential: the mother who walks an hour each way to gather cooking fuel or to bring a sick child to the local clinic is neither earning nor studying during that hour, because the bus doesn't go where she needs, or even if it does, it costs too much.

To demonstrate the importance of a full frontal approach to achieving the Goals in urban areas, the Earth Institute at Columbia University launched the Millennium Cities Initiative during 2005 in order to assist mid-sized sub-Saharan African cities address these complex challenges. The current roster of Millennium Cities includes: Mekelle, Ethiopia; Kumasi, Ghana; Kisumu, Kenya; Blantyre, Malawi; Bamako and Segou, Mali; Akure and Kaduna, Nigeria, and Louga, Senegal. In general, the cities chosen are capitals of the regions where the Millennium Villages Project, another Earth Institute initiative, is assisting smallholder farmers in making the transition from sub-subsistence agriculture to sustainable commercial agriculture together with related non-agricultural economic activities.[1]

With more than half of the world's population now living in towns, cities, and the clear majority of the world's gross national income coming from urbanized regions, it is clearly vital that the fundamental human rights embodied in the MDGs be achieved in urban areas. Indeed, to escape extreme poverty and ascend the ladder of economic growth and development, one essential component of a necessarily complex set of solutions includes strong and well-functioning cities. Urban regions must be capable of delivering essential human services, constructing and managing adequate infrastructure, transportation, and telecommunications connectivity, and supporting a healthy, productive, and engaged citizenry with access to the essential exchange of information necessary both to thrive in the today's global economy and to participate in the international community of ideas*.* Succeeding in this quest by the MDG target date of 2015 will require a series of systematically conceived, carefully targeted, wide-ranging interventions across all economic and social sectors. Measuring the size of the gap in each sector, thinking deeply about how to meet these challenges, and aiding this carefully selected group of cities in their efforts to do so constitutes the main purpose of the MCI.

Strengthening farm-to-market linkages is a key strategy for promoting economic development in these urban regions. Once the farmers in the Millennium Villages begin harvesting significant agricultural surpluses, their next move is to add value to their production by taking full advantage of urban infrastructure for agricultural processing, manufacturing, transportation, and distribution of their products to domestic, regional and international markets. Helping to transform these combined rural-urban dynamics into regional economic growth engines is central to MCI's agenda.

Toward this end, the MCI is helping to mobilize substantial public and private capital investment long overdue in all of the Millennium Cities – primarily in infrastructure, but also in a variety of economic and social sectors capable of creating local livelihood opportunities that enable businesses and households to thrive in place rather be forced to migrate to Africa's overcrowded "megacities" such as Nairobi, Dakar, Lagos, and Kinshasa. To galvanize business enterprise development, the MCI seeks to offer entrepreneurial training, expand access to private financing, and, wherever possible, to strengthen microfinance institutions by expanding the scope, quality, and range of financial and educational services they provide.

To further advance the global MDG agenda, the MCI is matching external partners with the Millennium Cities to help meet clearly identified needs in the social sector. Bi- and multilateral, corporate and non-profit development partners have already delivered to these severely underserved metropolitan areas whole series of medical trainings, screenings and other direct services; medical supplies and equipment, and research expertise in a wide spectrum of fields, from preventing gender violence and fostering early childhood development, to enhancing the regulatory environment for investment and increasing the potential for carbon trading under the Kyoto Protocols.

To accomplish these objectives, the MCI has adopted a five-part methodology, beginning with two distinct areas of investigation undertaken in each Millennium City: 1) a series of needs assessments and cost analysis for key MDG-related sectors, more precisely measuring the steps required to achieve the MDGs in such areas as public health, education, water and sanitation, and gender equality; 2) the concurrent formulation, through careful research, of a public and private investment strategy predicated on the city's and region's strongest assets, while identifying and leveraging essential infrastructure improvements to help attract and retain increased inflows of foreign direct investment. These two research trajectories converge in the third phase of our work, when MCI's findings are shared with stakeholders so that, as fully informed citizens, they can determine their own development priorities and generate a comprehensive development strategy for their city and urban region.

In the course of MCI's initial research phases, stakeholders' views are solicited -- as consumers of public services, public officials, business owners, operators, managers, and employees – regarding the most glaring economic, social, and physical deficits and how to remedy these. During this third phase of MCI's work, participatory engagement and local ownership become central, as urban residents and leaders, fortified by MCI's research findings, seek consensus as to which MDGs might be pursued and at what cost.

For example, key stakeholders might decide to press for a couple of "quick wins" such as relatively low-cost installation of girls' latrines in schools, which has been demonstrated to substantially increase girls' school enrollment, especially in relation to the modest cost of such an investment. Alternatively, stakeholders may choose major infrastructure investments, including water filtration plants or trunk roads, either of which can be highly beneficial in enhancing public health, school attendance, livelihood options, the efficiency of trade, and access to markets. The top-ranked priorities will become the basis for the fourth phase in our work: helping each city to generate a fully integrated, MDG-based City Development Strategy that incorporates those aspects of the investment and social-sector agendas deemed most important by the citizens and their leaders.

These City Development Strategies are vital for achieving nationwide economic, social, and governance decentralization, enabling local and regional governments to seek long-term financing from national governments and global donors solely on the basis of technical criteria and proven needs. Such economic strategies must be bold enough to budget sufficient resources for 100-percent MDG accomplishment over time, and they must be responsible for building into their strategies accountability, transparency, and ongoing monitoring to ensure a clear and direct correlation between the level of financial support and the actual immediate and long-term results.

The MCI will assist the Millennium Cities and their stakeholders at all stages of this investment and development process, by facilitating extensive consultation and collaboration among the various citizen stakeholder communities. Such activities include assisting each city to draft, review, revise, and approve its integrated MDG strategy; advising city officials on how to engage and obtain support from their respective regional and national governments, and then, in partnership with national government leaders, presenting the strategy to appropriate international donors and investors with the relevant interests and desired capabilities.[2]

Finally, the MCI will produce a handbook to document the process of generating these comprehensive urban development strategies. In addition, the MCI will offer workshops for current and future Millennium City public and private sector leaders, to discuss best practices and lessons learned.

To give some perspective, the following paragraphs describe in greater depth the social aspects of the MCI project and the needs assessments, the household survey, and the representations to various stakeholders of the relevant findings resulting from this research.

The MCI's Needs Assessment instruments were developed by the United Nations Millennium Project, under the overall direction of then-UN Secretary General Kofi Annan and his Special Advisor, Earth Institute Director Jeffrey D. Sachs, as part of the UN Millennium Project's effort to help both beneficiary and donor governments understand the gaps in MDG coverage and the costs of adequately addressing such funding gaps. The United Nations Development Program (UNDP) currently manages these tools and techniques through the UNDP Poverty Unit's MDG Support Group.[3]

In general, national government Ministries of Planning and Finance are utilizing such complex instruments to determine future budget expenses to achieve the MDGs in association with other relevant agencies and departments. The MCI's use of the UNDP needs assessment models for the Millennium Cities is the first application of these tools at the municipal level. Some of the models clearly require adaptation, or "localization," to be useful for local governments.[4] The MCI is engaging in research and action on a case-by-case basis, with the eventual intention of preparing a full set of models that can be effectively applied in urban regions throughout the developing world. In addition to quantitative models, the MCI is producing complementary qualitative narratives to highlight and expand upon key statistical and analytical insights.

Beyond these formal needs assessments, the MCI has generated a comprehensive, poverty-related household survey designed to study and identify the particular web of factors that entrench urban residents in severe poverty. The research results from this bottom-up, multi-sector demand-side survey, coupled with the cost estimates derived from the UNDP needs assessments of what it will take to fill the gap in each sector on the supply side, will enable the MCI to develop a detailed model of poverty factors unique to each city. This approach will generate a clear understanding of which sectors are farther along toward filling their MDG gaps, and which sectors need added financial support and technical assistance. Where funding and resource capacity permits, the MCI will use GPS mapping to observe not only which *sectors* need the most help, but also which urban communities within the city and region need the most help.

The MCI will communicate these findings though a series of consultative workshops convened together with municipal governments, local non-governmental organizations (NGOs), and many other vital stakeholder groups. It is critically important that all associations and individuals wishing to be represented at these workshops are included, and that everyone's views are respectfully presented and heard during such meetings. In order to reach large numbers of stakeholders, workshops may be held in multiple neighborhoods, with translators, childcare, and other necessary services provided, along with extra sessions scheduled as needed. Simple and understandable summary versions of the research findings are prepared for these workshops. Such graphic, low-technology audio-visual presentations of the Millennium City's MDG agenda by sector and place are designed to empower participating stakeholders with the facts that can enable them to agree upon and carry out well-informed decisions.[5]

MCI's investment analysis and recommendations will be presented with the other research findings, to be factored into constituents' decision-making. Overlaps – areas where severe need and/or opportunity might be highlighted in more than one sector – can help provide both the strategy and rationale for encouraging major infusions of investment capital and/or development financing. A GPS map of the Bamako riverfront, for instance, or of Kisumu's access to Lake Victoria, might revealing genuine potential for tourism, but at the same time may point out important problems to be addressed such as increased childhood morbidity due to water-bred diseases, significant environmental contamination, and periodic flooding. These problems, which also constitute major barriers to private investment, clearly must be solved, both to advance the city's public health agenda and to enable the productive use of rivers or lakes in economic development initiatives promoting market-based tourism.

When local leaders and stakeholders have agreed to a set of ranked priorities, a consultative group, working with technical support from the MCI, will draft the City Development Strategy to focus on the consensus of priority actions, including investment objectives for the city as a whole. Once approved by key stakeholders, each completed City Development Strategy will then need be converted into a specific comprehensive plan, complete with budgets and timetables, and will require the financial and policy support of governments, donors, private investors, and other development partners in order to succeed.

The next steps to implement the City Development Strategy involve documentation, advocacy, and investment promotion at the regional, national and international levels. Individual partners will be enlisted to invest in and assist different sectors and places. Capacity-building workshops will be a vital element of the ongoing implementation, so that the city can move the strategy forward to its complete fulfillment. Continuous feedback concerning both the process and outputs will be critical in helping the MCI become more inclusive and responsive in each local context, thus improving the overall economic methodology as it is increasingly replicated and scaled-up globally. Such valuable critiques also will be incorporated into the MCI Handbook, hopefully resulting in an effective guide for other cities and urban regions eager to achieve the MDGs while generating dynamic and environmentally sustainable economic growth.

In sum, the Millennium Cities Initiative has engaged in a comprehensive approach to achieving the Millennium Development Goals in urban regions because cities' and donors' best-intentioned attempts to accomplish the MDGs individually and incrementally have not been working well enough to succeed. Despite donors' understandable interest in addressing one problem at a time, the fact is that all significant economic, social, and environmental development is inextricably interconnected, meaning that partial success in some aspects of the MDGs remains quite vulnerable to the other "weak links." With mothers still dying from childbirth and their children dying of malaria, the clock is fast running out, and the MCI's comprehensive approach to poverty reduction, public health, and sustainable prosperity offers hope for the world at a time when the need for rapid and long-lasting solutions is extraordinarily urgent.

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[1] The Millennium Villages Project is a joint undertaking of the Earth Institute, the United Nations Development Programme (UNDP), the non-profit Millennium Promise, and an increasing number of donor and host governments.

[2] E.g., the traditional donor community, development finance institutions, international agencies and the growing pool of interested international investors, including such newly engaged actors as China and other Asian powers, South Africa, Latin America and the Middle East.

[3] http://www.undp.org/poverty/mdgsupport.htm.

[4] This is particularly true for the infrastructure sectors (e.g., transport, energy, ICT), but can also hold for public health, where, for instance, information regarding the costs of HIV/AIDS or malaria interventions in a given city, the administration of which might come through of the Global Fund to Fight HIV/AIDS, TB and Malaria, might not be known to municipal health officers.

[5] However, the finished complement of needs assessment analyses will be available to anyone interested. The most elegant representations of such findings are the so-called development diamonds championed by Sumila Gulyani and others. See, for example, diagrammatic representations in, "Affordable Energy Provision for Water and Sanitation Services in Developing Country Cities" (04/03/07, Gulyani, S. and Talukdar, D. 2006, UN Habitat Presentation); "Slum Real Estate: The low-quality high price puzzle in Nairobi's slum rental market and its implications for theory," Washington DC: World Bank, Urban Symposium. May 2007 http://www.worldbank.org/urban/symposium2007/papers/gulyani.pdf; and Gulyani, S. (2006), "Kenya inside informality: Poverty, jobs, housing and services in Nairobi's slums." Report no. 36347-ke, World Bank, Water and Urban Unit.