



Shaping Inclusive Markets

How funders and intermediaries can help markets move toward greater economic inclusion

By Harvey Koh, Samantha King, Ahmed Irfan, Rishi Agarwal, Ashvin Dayal, and Anna Brown

Contents

Introduction

What is an inclusive economy?

Section 1: The Progress of Markets

We share insights from historical case studies, and introduce the concept of market system innovations

Section 2: The Role of Market System Innovations

We explore the different kinds of market system innovations, and their role in transforming markets

Section 3: Harnessing Market System Innovations

We introduce the MSI approach, and provide practical guidance for funders and intermediaries

Conclusion

Recommended Resources

Acknowledgements

Introduction

In 2014, Thomas Piketty, a French economist, ignited an international furor with the publication in English of his book, *Capital in the Twenty-First Century*. Piketty argued that global economic inequality, which had been declining between the 1930s and the 1970s, was now back at high levels not seen since the Industrial Revolution. In 2015, ahead of the World Economic Forum meetings in Davos, Oxfam announced that wealth inequality was reaching historic highs, with the combined worth of the world's richest 1 percent about to overtake that of the remaining 99 percent. These findings sparked intense debate about the nature and structure of the societies we live in.

Much of this debate confirms what many people already feel: that deep inequalities are ingrained into the markets and economic systems in which they are participating. Even where progress has been made at narrowing the gap between richer and poorer, multiple dimensions of disadvantage—such as race, caste, gender, and disability—continue to exclude large groups of people from greater prosperity and wellbeing. We can see how future generations are also being disadvantaged because we are not doing enough to stop the over-exploitation of Earth's finite resources.

The questions of how markets work, and who they work for, have never been more pressing.

Teams at FSG and the Rockefeller Foundation, as well as other funders and intermediaries, have been working to harness the potential of markets for positive social impact for over a decade. Although there have been significant advances in areas such as shared value, impact enterprise, and impact investing, the prospect of large-scale, systemic market change remains elusive. We all need to do better.

Our teams realized that we needed to better understand how positive progress in markets *actually happens*, not just how we would like it to happen. If we could be better informed about the process of change, we could then refine our approach to better support the changes that reshape markets toward greater economic inclusion. In this report, we share the findings from our research and analysis as well as a proposal for how we and others could use those insights to be more effective going forward.

What is an inclusive economy?

Everyone who is reading this will have his or her own views about what an inclusive economy is, but these tend to be tacit. We know it when we see it, but find it difficult to describe or define it precisely. For this work, we needed a fuller and clearer definition of inclusive economies, so we adopted the framework developed in 2016 by the Rockefeller Foundation.

The Foundation defines an inclusive economy as one in which there is expanded opportunity for more broadly shared prosperity, especially for those facing the greatest barriers to advancing their well-being. This multi-dimensional framework (shown in Figure 1) features five key characteristics—growth, equity, sustainability, stability, and participation.¹

Figure 1: Five Characteristics of Inclusive Economies (Rockefeller Foundation, 2016)



We have used this framework in our research as a lens for understanding outcomes in the markets we examined and—importantly—to do this across multiple dimensions relevant to the overall theme of inclusion. It provided a consistent and systematic basis for assessing the different markets we studied and for tracking changes over time. It has also provoked deeper reflection about tensions and risks that we might have overlooked if we had focused only on tracking market growth or headline indicators such as income per capita.

It is not our intention to suggest that everyone should align themselves with this set of goals, nor that this is the only correct way of defining an inclusive economy. However, we hope that this framework might be helpful to others as they reflect on their own goals, which may relate to one or more dimensions of the framework.

¹ For more information on this framework, please visit www.inclusiveeconomies.org.

Section 1. The Progress of Markets

In India, Gujarati smallholder dairy farmers, once exploited by milk traders, now control one of the largest food product businesses in the country. In Costa Rica, the rise of ecotourism has contributed to greater prosperity in local communities as well as a dramatic reversal of deforestation trends, with forest cover doubling since the 1980s. In Kenya, hundreds of thousands of people once limited to meager wages as laborers on tea estates now receive more than 70 percent of the export value of tea as smallholder tea farmers.

As we look across the world, these stories of progression toward more inclusive economies are certainly the exception rather than the rule. But could they teach us something about how these changes happened, and how we might be able to support similar progress in other markets?

With these questions in mind, we undertook a 10-month, in-depth study of real-world cases where whole markets reaching millions of people had made systemic progress toward the inclusive economies ideal. From a long list of more than 80 potential cases, we conducted preliminary assessments of 20 and performed in-depth investigations into 7 that showed signs of systemic change and demonstrated progression against several dimensions of an inclusive economy. As summarized in Table 1 below, these seven were drawn from all over the world and from a variety of sectors. Four were chosen primarily for greater economic inclusion of producers, and three for greater inclusion of consumers.

With each case, we wanted to understand what had changed in terms of outcomes using the Rockefeller Foundation’s inclusive economies framework, and how that change had been achieved. We examined these cases not through the lens of a single philanthropic or aid intervention—indeed, it was difficult to identify a sole protagonist in these cases—but by piecing together the extended narratives of change in each case from multiple perspectives.

Table 1: Summary of In-Depth Case Studies

CASE	PERIOD	TRANSFORMATION	PROGRESS TOWARD A MORE INCLUSIVE ECONOMY		
Coffee in Colombia	1920-2016	From a market dominated by large plantations; to a market dominated by smallholder farmers	Equitable <ul style="list-style-type: none"> Smallholder farmers receive 60%–70% of final export price of coffee 	Participatory <ul style="list-style-type: none"> Growth in number of coffee farmers: fewer than 80,000 to 560,000 between 1920s and 2004 	Growing <ul style="list-style-type: none"> Price premium of 40% over coffee from Brazil, the world’s largest producer Growth in coffee exports: over 3.5x increase between 1930 and 2016
Dairy in Gujarat, India	1940-2016	From a market in which dairy farmers were exploited by middlemen; to farmers now owning one of the largest food products marketing organizations in the country	Equitable <ul style="list-style-type: none"> Dairy farmers receive over 70% of market price of dairy products 	Participatory <ul style="list-style-type: none"> Cooperative dairying has spread from 2 to 33 districts, between 1950 and 2016 	Growing <ul style="list-style-type: none"> Milk production increased from under 2 million tons to over 12 million tons, between 1960s and 2016
Tea in Kenya	1950-2016	From a market dominated by multinational corporations and large estates; to one dominated by smallholders	Equitable <ul style="list-style-type: none"> Smallholders receive 70%–80% of the final export price of tea 	Participatory <ul style="list-style-type: none"> Over 650,000 smallholders participate formally in 2016, compared with limited and illicit activity before 1950 	Growing <ul style="list-style-type: none"> Tea contributes over 21% of Kenya’s foreign exchange earnings in 2016, up from 7% in the 1970s Price premium of more than 20% to Indian tea,

					and more than 100% to Tanzanian tea
Tourism in Costa Rica	1980-2016	From an agro-export-led economy with conventional tourism; to a services-led economy driven by ecotourism	Equitable <ul style="list-style-type: none"> • Decrease of 16% in poverty levels in communities next to protected areas between 1973 and 2000 	Growing <ul style="list-style-type: none"> • Growth in receipts from international tourism, from less than USD 80 million to over USD 3 billion, between 1980s and 2016 	Sustainable <ul style="list-style-type: none"> • Forest cover has more than doubled, from 21% of total land area to more than 50%, between 1980s and 2012
Water in metropolitan Manila, Philippines	1983-2016	From a market served by an inefficient state utility and informal providers; to a market served by private utilities with an inclusive mandate	Equitable <ul style="list-style-type: none"> • Substantial decreases in price per unit, particularly for lower-income households 	Participatory <ul style="list-style-type: none"> • Over 90% of consumers have 24/7 safe water access in 2016, up from less than 26% in 1997 	Growing, Stable <ul style="list-style-type: none"> • Improvement in wellbeing: 51% reduction in diarrhea cases in East Manila between 1997 and 2008
Retail Financial Services in Kenya	2000-2016	From a market catering mainly to the affluent and urban; to a more expansive market serving lower-income groups, including in rural areas	Equitable <ul style="list-style-type: none"> • Proportion of least affluent households using formal financial services increased from 22% to 58%, between 2006 and 2016 	Participatory <ul style="list-style-type: none"> • Proportion of adults using formal financial services increased from 28% to 75%, between 2006 and 2016 	Stable <ul style="list-style-type: none"> • Proportion of population using non-secure, informal methods for remittances reduced from 84% to 38%, between mid-2000s and 2013
Retail Financial Services in the U.S.	1980-2016	From a market that excluded low-income and minority communities; to a market with a wider array of financial services for low-income and minority communities	Equitable <ul style="list-style-type: none"> • Increase of 4.9x in mainstream bank lending to underserved communities between 1996 and 2015 	Participatory <ul style="list-style-type: none"> • Proportion of all households with a transaction account increased from 86% to 93%, between 1989 and 2013 	Stable <ul style="list-style-type: none"> • Proportion of non-white/Hispanic households with a retirement account increased from 18% to 34%, between 1989 and 2013

It is important to note that these cases demonstrated progression against multiple dimensions of inclusive economies over time. It is also notable that all of the producer-focused cases (in Colombia, Costa Rica, Gujarat, and Kenya) demonstrated strong *growth* performance, which indicates that they were very much focused on value creation in order to bring in an increasing level of material resources, rather than on merely redistributing value, say, from the rich to the poor. These were reflected in the high-margin business strategies advanced in each case, such as high-quality exports that commanded a premium on world markets (Colombia, Kenya), value-chain integration (Colombia, Gujarat, Kenya), extension into value-added products (Colombia, Gujarat), and effective retail brand development (Colombia, Costa Rica, Gujarat).

We should also note that none of them have a perfect record in terms of advancing greater economic inclusion. For example, sustainability has been a relatively weak point for several of these cases: In Colombia coffee, expansion of cultivation at higher altitude has contributed to deforestation and contamination of water sources, while in Gujarat dairy, greater levels of cattle-rearing have increased methane emissions (albeit at a lower level compared to an industry geared to beef production for the same population). Even in Costa Rica, where dramatic sustainability gains have been recorded, the tourism boom and the rise of “greenwashing” are placing ecological systems under renewed pressure.

Meanwhile, in the United States, greater access to financial services for poor and marginalized communities has involved harmful, predatory practices such as sub-prime mortgages and payday lending, alongside more benign offerings of responsible bank lending and retirement accounts.

A Story of Change – Dairy in Gujarat

The year was 1945. In the Kaira district of Gujarat in the west of India, small dairy farmers were unhappy. For decades, they had faced small local markets for their perishable produce, and had to rely on exploitative milk traders to sell farther afield. When contaminated milk had caused a disease outbreak in Bombay (now Mumbai) a few years earlier, it seemed as though an opportunity was opening up: The colonial administration had moved to establish the Bombay Milk Scheme to secure the safe supply of milk and identified Kaira as a good source. But it was Polson's, a private dairy in the region, that demonstrated that it could pasteurize and transport liquid milk safely across the 350 kilometers from Kaira to Bombay, so it secured monopoly rights to collect milk in the area. While access to the new Bombay market was attractive to the farmers, the low prices and unfair treatment they received at the hands of Polson's were not.

Frustrated by their inability to secure a fair price for their produce, the dairy farmers asked the leaders of the Indian independence movement for help. The movement nominated one of its leaders, Tribhuvandas Patel, to help the farmers organize themselves into cooperatives to more effectively fight for their interests. The cooperatives asked for rights to directly supply the milk scheme, but these requests were denied. In response, the cooperatives organized a two-week strike where they poured milk out on to the streets instead of selling it to Polson's. This had the intended effect: Faced with the collapse of the scheme, the Milk Commissioner acceded to the farmers' demands. The Kaira District Cooperative Milk Producers' Union was formally registered in December 1946, with Tribhuvandas Patel as its Chairman.

But how was the Kaira Union to transport milk to Bombay? They had no facilities of their own, so their admission to the scheme had little practical impact. However, this was soon to change. In 1947, India achieved its independence from British rule. The leaders of the independence movement, who had assisted the farmers in their struggle, now found themselves in power in Delhi, and soon after facilitated the lease of part of a government creamery in Kaira to the Union. Within the space of a few short years, dairy farmers in Kaira had secured direct access to the Bombay milk market.

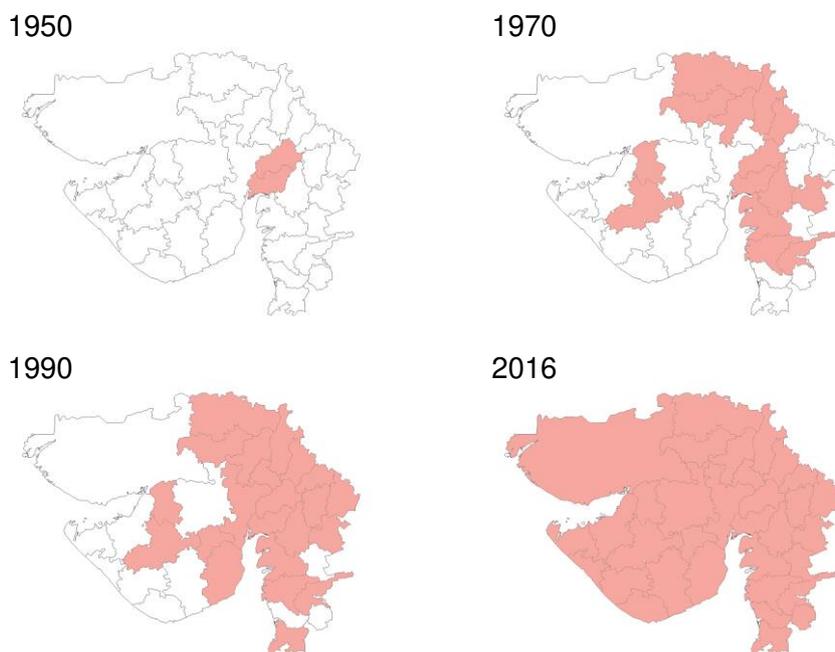
However, the Union still faced a number of challenges. A key one was how to deal with volatility in milk supply and demand: milk was highly perishable and could not be stored easily to smooth out variations. The conventional approach to storage was to convert liquid milk into powder, but these technologies only worked with cow's milk, while most of the milk produced in Gujarat was from buffaloes. The new managing director, Dr. Verghese Kurien, determined that a solution should be found and hired a technologist, H. M. Dalaya, to address this and other problems. In 1954, Dalaya made his breakthrough, successfully making milk powder from buffalo milk.

This not only solved the pressing problem of storage but also paved the way for the Union's later entry into butter, cheese, and other value-added products, all under the "Amul" brand it introduced in 1957. This strategy allowed it to capture more value in the dairy sector and remain economically resilient despite the downward pressure on milk prices.

In truth, the Union's successful entry into the butter market in 1956 relied on more than technology and good marketing, though both were important. In that year, India suffered a major foreign exchange crisis. With the government keen to find ways to reduce imports, Kurien approached the Minister of Commerce and suggested that the Union could supply the needs of the Indian market if the butter imports were curtailed. This worked: Butter imports were restricted in 1956 and banned a year later, locking out dominant foreign brands and clearing the way for Amul butter. Meanwhile, Kurien had secured a grant from Unicef to build out his butter production facilities by agreeing to distribute free milk equivalent to 1.5 times the value of the grant to children and expectant mothers.

Figure 2: Spread of Dairy Cooperative Model Across Gujarat²

Shading denotes spread of cooperative dairying district unions currently affiliated with Gujarat Cooperative Milk Marketing Federation Limited (GCMMF).



By the 1970s, the “Anand pattern cooperative” model was spreading across Gujarat (as shown in Figure 2), assisted by the establishment of the Gujarat Dairy Development Corporation by the state government, an agency that would support new groups of farmers in other districts wishing to adopt the model. In 1973, the Kaira Union joined with cooperatives in other districts to form the Gujarat Cooperative Milk Marketing Federation Limited (GCMMF), which also inherited the Amul brand. As more districts and farmers joined, production grew, and ever-greater resources were available for investment into technology, marketing, and production facilities. To address the ever-growing need for skilled managers in the business, in 1979 Kurien spearheaded the founding of the Institute for Rural Management, Anand, which today remains a premier institute for the study of agriculture and the rural economy.

In the 1990s, the story broadened out beyond the cooperatives. Another balance of payments crisis in 1990 set the stage for the wide-ranging economic reforms initiated by Prime Minister Narasimha Rao and his Finance Minister, Manmohan Singh. As part of this, the dairy sector was liberalized, creating space for the entry of new private companies. However, new companies coming into the Gujarat dairy sector would have to match the price and terms offered by the cooperatives to dairy farmers; in effect, the Federation had changed prevailing norms and expectations across the market. In the early 2000s, the government introduced new legislation providing for the formation of “producer companies” which would operate on similar principles to the cooperatives but within a limited company structure. Today, a producer company, Maahi, is one of the main competitors to the cooperatives in Gujarat.

Throughout this journey, funders played important supporting roles. The government of New Zealand provided funding and engineering expertise for the first of the Kaira Union’s own dairy plants. Oxfam

² Districts without a dairy cooperative union but served by the union in a neighboring district are considered to be participating in cooperative dairying. Three district unions for which exact dates of establishment are not available are assumed to have been established after 1990. District boundaries in 2016 have been used across all time periods for ease of illustration, even though new districts have been created over time. Gujarat was part of Bombay state until 1960.

helped fund a cattle feed plant in 1964. As described earlier, Unicef funded the Union's move into butter production. The World Bank contributed substantial funding to "Operation Flood," the Indian government's initiative to support expansion of the model in Gujarat and across India.

Widening Our Lens on Innovation

There are many definitions of innovation that relate to the diverse contexts in which innovation takes place. Some of us might think of new business ideas, while for others technological breakthroughs come to mind.

However, if we take the fundamental sense of an innovation to be a break from established thinking or practice in a way that contributes to progress, and reflect on the story of change in Gujarat dairy, we begin to see a much wider spectrum of innovation. There were certainly innovations in technology, such as the breakthrough in producing milk powder from buffalo milk, as well as numerous business model innovations, such as the extension of cooperative activities beyond liquid milk into butter and cheese, and the development of the now-iconic "Amul" brand for the entire product range.

But we also see powerful organizational innovations, such as when Tribhuvandas Patel helped the dairy farmers, individually weak, to collectivize for the first time and become stronger as a unified group. We see innovations in political action and influencing, with the unprecedented strike action that secured access to the milk scheme, and Kurien's lobbying of the government to restrict imports of butter. Indeed, if we widen our lens further, we also see the innovations in the public sector, from the lease of government creamery to the cooperatives, to the butter import ban, to the liberalization of the dairy sector and the legislation allowing for the establishment of producer companies. All of these were "firsts" that involved individuals deciding to break the established pattern in their respective contexts and called on them to exercise some combination of skill, ingenuity, and boldness.

One of the popular narratives in the philanthropic and aid sector today is about how we could take a single innovation and scale it up by overcoming obstacles in the wider system around it. Indeed, even experts at FSG and the Rockefeller Foundation have tended to operate with this perspective, and written in the past about how this could be approached (see sidebar "Beyond the Pioneer").

However, when we look across the broad sweep of our case studies, what we see is less about the scaling up of any one innovation and more about **how a panoply of innovations comes together over time, interacting with and building on each other, in order to progress the market**. Importantly, these innovations reshaped not just business models and practices, but also the formal laws, regulations, and policies that apply in the market and the informal norms that guide the behaviors of various actors. Put more simply, we see innovation in relation to both the players and the rules of the game.

This has implications for who we consider to be relevant innovators in these market shifts. While entrepreneurs and technologists figure prominently in our narratives, we also see other profiles of innovators across the wider system in which the market operates—community organizers, leaders of social movements, academic researchers, political leaders, and civil servants, among others. Most of these innovators were individuals who were deeply embedded in the societies where the change was taking place; in other words, they were part of the local system, not outsiders. And the skills and ingenuity that they exercised were not only technical, but also political in that the effective influencing and mobilization of other people was critical to their effectiveness.

In the rest of this report, we refer to these innovations as *market system innovations*.

Our interest in framing market system innovations in this way goes far beyond semantics. For funders and intermediaries, one of the key problems with conventional "scaling up" approaches is the difficulty of addressing and overcoming systemic scaling barriers—it is one thing to see what obstacles are in the way and another to be able to remove them.

But what if we saw the wider market system not only as a place of failure, challenges, and barriers that we needed to somehow fix, but also as the source of innovation and change that could be supported

and harnessed? Many of us working with market-based solutions and impact enterprise were used to seeing this innovative potential in the business sector, but were less accustomed to looking for it and appreciating it in other sectors, such as civil society and the public sector. And yet, just as is in the business sector, the pockets of innovation in the wider system represent the glimmers of hope, the seeds of opportunity that hold the potential for transformation. We believe that harnessing *all* of these areas of innovation is the key to helping to advance more inclusive economies, and this will be our focus in the rest of this report.

In the next section, we delve deeper into how market system innovations come together in order to drive progress, drawing richly on examples from across our in-depth case studies. Then, in “Harnessing Market System Innovations,” we draw out the implications of this work and propose a practical approach to engaging with market system innovations.

SIDEBAR: Beyond the Pioneer

In 2014, Harvey Koh, one of the authors of this report, was the lead author of *Beyond the Pioneer*, a report that described how ecosystem barriers constrained the scaling of innovative business models for impact enterprise. The report made the case for the practice of industry facilitation to help address those barriers.³ That approach continues to be useful as a way of understanding systemic challenges from the perspective of an individual model or firm, and so could still be helpful for, say, an entrepreneur or an investor. However, there are limitations in that approach for those focused on whole market systems change, and this is where we hope this new report will add new insight and practical guidance.

³ Koh, H., Hegde, N., and Karamchandani, A. (2014) *Beyond the Pioneer: Getting Inclusive Industries to Scale*, Monitor Deloitte.

Section 2. The Role of Market System Innovations

In the previous section, we introduced our thinking on how market system innovations could be a key driver in changing markets toward greater economic inclusion. In this section, we investigate how they fit into actual processes of transformation to form a clearer view of how we might identify and harness them in the future.

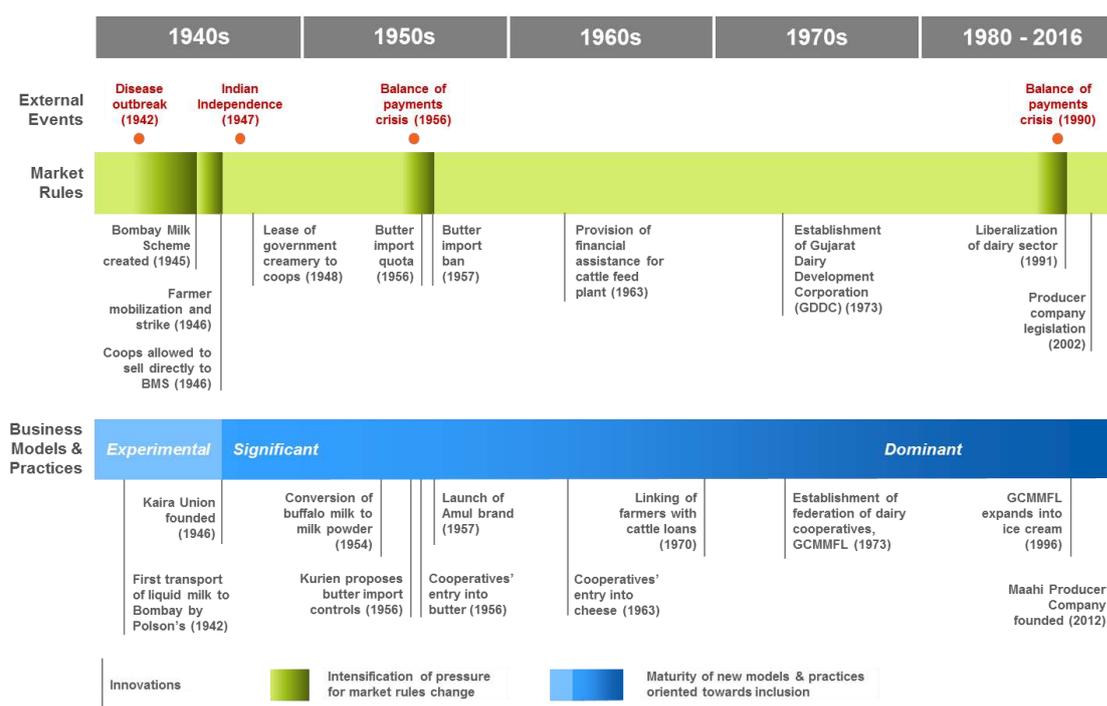
Sidebar: What is a Market System Innovation?

We have defined a market system innovation as a break from previous practice in its specific context, either radical or incremental, within the market system, that helps to advance market change toward greater economic inclusion or mitigate risks in the market that could erode such inclusion.

Dairy in Gujarat Revisited

Let us return to the story of the Gujarat dairy market, which we narrated in the previous section. To better understand market system innovations, we have to more clearly see how they relate to each other and to the overall progression of change. If we take the various innovations that reshaped business models, practices, and market rules, and plot them on a timeline, we see something like Figure 3 below.

Figure 3: Timeline of Change – Dairy in Gujarat



A number of things become clear from studying this timeline.

One is the long timeframe over which the overall market actually changes. It takes decades for the new ways of working championed by the cooperatives to actually become dominant in the marketplace. This should not be surprising, given that markets do not change overnight but instead evolve over time as market forces play out and as customers (and suppliers) are won and lost. Market system innovations punctuate this journey, but their impacts are realized over a period of time.

Another is the interaction between market rules and business models and practices. The opening of the Bombay Milk Scheme and the lease of the government creamery were the critical changes in rules that allowed the Kaira dairy farmers to become a significant presence in the market. Later, the restriction

on butter imports cleared the way for the cooperatives to extend into value-added products and capture more value for farmers. In the 1970s, the establishment of the Gujarat Dairy Development Corporation facilitated the expansion of the cooperative model to further districts. Change flowed in the other direction too: Cooperative leaders such as Tribhuvandas Patel and Verghese Kurien were adept at exploiting opportunities to influence market rules in advantageous ways.

If we look more closely at periods of changes to market rules, we notice that they go through distinct cycles of change: We often see a period where pressure on rule makers (typically ministers, civil servants, and legislators) to make a particular change builds and intensifies, and as the change is made and implemented, this pressure dissipates. Some innovations (such as the farmers' mobilization and strike) are useful because they generate pressure in themselves, while others exploit external events (as when Kurien lobbied the Commerce Minister during a foreign exchange crisis). Indeed, our analysis shows at least three external events that led to pressure for pivotal changes to market rules in the Gujarat dairy case, as well as one—Indian independence—that actually replaced the rule makers in government with people more sympathetic to the cooperatives' cause.

If we look to the far right of the timeline, we see that change has continued to take place in recent years, many decades after the beginning of the story. It would not be hard to imagine a researcher studying this market in the 1980s concluding that the destination had been reached, now that the cooperatives were the dominant force in the marketplace. But they would have been wrong. Innovations since that time have brought the entry of producer companies, and this has extended more inclusive practices beyond the dairy cooperatives. And, as we noted in section 1, there are and will continue to be further challenges and risks as the story rolls on, both to the businesses themselves, and to various inclusive economies outcomes experienced by individuals and households.

SIDEBAR: Smallholder Case Studies

Similar patterns of market development can be seen across the cases of Gujarat dairy, Colombian coffee, and Kenyan tea. In all three cases, we saw a situation where autonomous, smallholder-owned, local businesses operated in a competitive context, even as they pooled their efforts through strong federated bodies—GCMMFL in Gujarat, FNC⁴ in Colombia, and KTDA⁵ in Kenya—in areas such as research and development, infrastructure provision, downstream value chain integration, branding and marketing, and political lobbying. Because each of these smallholder initiatives faced powerful competition, both domestically and abroad, it made sense for smallholders to join together and exploit economies of scale wherever possible.

Gujarat and Colombia, which are the two most mature cases in terms of years elapsed, also show how the models and practices pioneered by these smallholder initiatives have now diffused beyond their original institutions. In Colombia, the FNC has lost share of the coffee export market in recent years to new smallholder associations, set up in new coffee growing areas and not linked to the FNC. These associations moved more quickly into the fast-growing specialty coffee space than the FNC and have reaped the benefits. However, these associations operate along similar principles to the FNC and its membership and also benefit from many of the investments made by the FNC over the years, not least in increasing international recognition of Colombian coffee as a premium brand.

⁴ Federación Nacional de Cafeteros, or National Federation of Coffee Growers

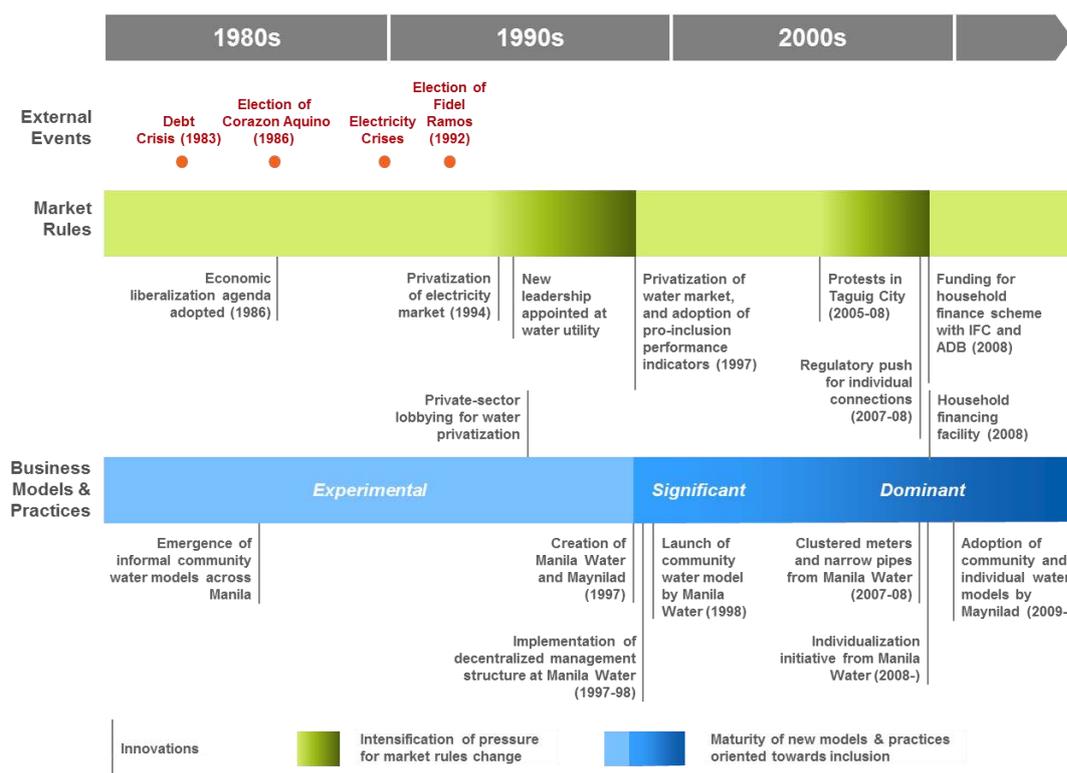
⁵ Kenya Tea Development Authority initially, then Kenya Tea Development Agency since 2000.

Water in Manila

Another of our in-depth case studies, on the water market in metropolitan Manila in the Philippines, exhibits the same key patterns and themes, even though the particulars are very different. The timeline for this is shown in Figure 4.

The water market in Manila, previously run by a state utility, was privatized in 1997. Thanks to a range of complementary innovations, the market has evolved in an inclusive manner: More than 90 percent of the population has access to reliable and safe piped water, up from 26 percent before, and prices per unit have fallen significantly, with the greatest improvements experienced by low-income households.

Figure 4: Timeline of Change – Water in Manila



But our analysis of this market system starts some time before 1997. In the 1980s, the excesses and crises of the Ferdinand Marcos regime eventually led to his ouster at the hands of the People Power Revolution; Corazon Aquino was inaugurated as President and began a program of economic liberalization. This was also a decade which witnessed a global trend toward economic liberalization in general, and the privatization of utilities in particular. By the end of the 1980s, electricity supply crises were prompting demands for privatization of the electricity sector, and this was implemented in 1994 under the administration of President Fidel Ramos, Aquino’s hand-picked successor. The success of the privatization of electricity soon led to calls for the same approach to be applied to the water market. External actors, including the International Finance Corporation (IFC) and the government of France, helped to encourage and advise a new leadership team at the water utility appointed by President Ramos.

In 1997, the water market was privatized, with two concessionaires—Manila Water and Maynilad—securing rights to supply east and west Manila, respectively. Crucially, the performance framework agreed at privatization included a number of targets oriented toward economic inclusion, such as increasing the proportion of total population covered by the network, and reducing the level of non-revenue water (i.e., water lost or stolen from the network). It would be quite a task to plug the leaks and reduce pilfering, but at least the solutions to these problems were well understood. However, improving coverage in a city like Manila—where much of the population lives in informal settlements with no experience of piped water connectivity—was a challenge that required real innovation.

It began with the implementation of a decentralized management structure at Manila Water. This meant that local managers were able to be more responsive to local conditions and build relationships with local political and community stakeholders. They saw that local entrepreneurs and community groups had for decades been supplying water to low-income households in informal settlements, and saw an opportunity to meet their total coverage targets.

Within this structure, Manila Water developed an initiative—known as Tubig Para Sa Barangay (TPSB)—to supply bulk water to these community networks: Local groups would organize their own last-mile infrastructure, monitoring, and collections, and Manila Water would sell more water and close the coverage gap. Households previously reliant on sources such as water tankers could now have cheaper, more reliable, and safer supplies. TPSB was the ultimate win-win proposition, or so it seemed.

While TPSB was indeed seen as a huge success in the early years, discontent was beginning to brew in some local communities by the mid-2000s. The problem was that household tariffs under TPSB, while lower than what they had paid before, were still higher than those being paid by higher-income households. This was because Manila Water's bulk tariffs were higher (because high-volume customers, such as industrial users, paid more per unit than low-volume customers) and community network operators then added on their mark-up. Between 2005 and 2008, protests in the Taguig City area of Manila, led by the local mayor, put forward demands that Manila Water make its pricing structure more equitable.

In response to this pressure, the water regulator pushed Manila Water to get low-income households individually connected to the network. The company drove a number of technical innovations in order to make this possible, such as the clustering of individual water meters at the edges of settlements and a new, narrower design of pipe, to more easily serve the last mile to households.

One final challenge remained: Households needed to pay a large up-front charge (equivalent to over US\$160) to get connected, and this was not feasible for many low-income families. In response, the government, together with the IFC and the Asian Development Bank, put together a financing facility for such households, allowing them to move to individual connections and then pay down the cost over time. As a result, in east Manila, low-income households, which are typically also the lowest-volume users of water, are now predominantly on the cheapest water tariffs rather than the highest.

Meanwhile, in west Manila, concessionaire Maynilad had been slow to implement improvements due to the heavy debt burden it inherited at privatization. Following a restructuring and transfer of ownership, Maynilad announced in 2009 that it would be replicating many aspects of the innovations pioneered in east Manila by Manila Water, resulting in positive gains spreading across all of metropolitan Manila.

On the face of it, the story of water in Manila bears no resemblance to the case of dairy in Gujarat: It concerns the privatized utility market in a large capital city, not a rural agricultural market. It moved much more quickly, because much of the infrastructure was already in place, and the business players were backed by large corporate groups (Manila Water is a division of Ayala, the country's largest corporation). But we can still see the same themes of market system innovations across the spheres of business models and practices, and market rules, contributing to processes of change that ultimately produce more inclusive outcomes at a systemic level.

In the rest of this section, we will take a closer look at how market system innovations have helped specifically in changing market rules and norms. Many practitioners working on market-based solutions in the philanthropic sector (and private-sector development in the aid sector) have come from the business world, so there can be a tendency to focus mainly on business changes in the process of market change, and overlook rules and norms. As we have already seen, such a perspective would be thoroughly incomplete.

Changing Market Rules

We have already seen how changes in market rules can be pivotal moments for overall market evolution. What is interesting when we look across our case studies is how these changes went beyond merely levelling the playing field or making them more efficient. Instead, they typically opened up new opportunities, compelled all businesses in the market to conform to certain behavioral standards, or even rebalanced the playing field in favor of players with particular models and practices. Examples include the following:

- In the early days of the Kenya tea case, the government halted the expansion of tea and coffee acreage by dominant multinational players, creating room for the establishment and early growth of KTDA, the smallholder tea initiative.
- In the early days of the Colombia coffee case, the government introduced a levy on all coffee exports and directed the proceeds to a wide range of smallholder development initiatives run by the FNC.
- In North Carolina in the United States, an Anti-Predatory Lending Law passed in 1999 imposed restrictions on high-cost mortgages, helping to reduce the prevalence of exploitative practices that harmed low-income borrowers.
- In Costa Rica, the adoption of environmental protection laws and the creation of national parks system in the late 1960s set the stage for the subsequent rise of ecotourism operators.

This is an important point because markets are not neutral arenas of competition—businesses playing in any given market have differing levels of resources and capacities, and varying strengths and weaknesses. Moreover, the rules governing a given market will often advantage one model or player over another. These advantages can sometimes be blatant (such as a granted monopoly) or more subtle (such as regulations that suit established companies but constrain innovative challengers).

The formal rules governing markets are set by the state and reflect the balance of competing interests prevailing upon rule makers, so these rules can be hard to change where there are powerful vested interests involved. In many countries, political and business power is closely intertwined, so it is not surprising that market rules tend to entrench the advantage of powerful incumbents. Even when market rules have changed in favor of greater economic inclusion, such players may continue to push for them to be rolled back. We can see this in the United States today, where factions within the financial services industry continue to lobby for the relaxation of laws and mechanisms that protect vulnerable consumers from exploitative practices, such as the Dodd-Frank Act and the Consumer Financial Protection Bureau.

It should be noted that the degree of opposition varied across our cases. It was less forceful when incumbents did not perceive the rule change to be a significant threat to their interests. In Kenya, established banks did not initially perceive the emergence of M-PESA, the mobile money platform, to be a significant threat, particularly as banks were set up to play a role in holding deposits for the new service. Of course, this situation did not last: within a few years, telecom providers had emerged as significant competitors to the banks by offering current and savings accounts on mobile money platforms. In response, the banks then sought and won a set of new regulatory openings to strengthen their competitive position through new services, such as agent banking services (where third parties such as retail outlets can conduct transactions on behalf of banks) and their own mobile virtual network operators.

Instances where changes represented (or *were* represented by their advocates as) opportunities for existing elites also saw more muted opposition. In Costa Rica, the Minister of Agriculture framed the benefits of the 1969 Forestry Law primarily in terms of its economic benefits in order to win support in the Legislative Assembly, although he had formulated the law to combat unregulated deforestation. In Kenya, the post-independence political elite had a vested interest in the KTDA initiative as they held significant tea farm holdings which could participate in the scheme and therefore benefit from its

success. In Manila, water privatization meant that powerful corporate groups were able to enter into and benefit from a large new market.

Where political opposition was significant, a variety of tactics were used to overcome political opposition. Sometimes, this was a direct appeal to more powerful forces. In Kenya, when KTDA leadership proposed to transition to in-house, ethnic African factory management, away from outsourced arrangements with European multinationals, they faced strong opposition from their board. KTDA's then General Manager, Charles Karanja, overcame this obstacle by appealing directly to President Jomo Kenyatta and his stated "Africanization" agenda.

In other cases, opposition was overcome by amplifying the pressure for change among key constituencies. As narrated above, when the Gujarati farmers' requests to rescind the Polson's monopoly were rebuffed, they went on a 15-day strike, threatening the supply of safe milk to the Bombay elites and heaping pressure on the Milk Commissioner to accede to their demands. In Kenya, KTDA's transition to full smallholder ownership in 2000 was triggered by protests from farmer activists who felt their interests were not sufficiently represented in the business and then channeled through parliamentary groups linked to tea-growing constituencies.

External events could also sometimes be leveraged to overcome opposition to change; crises in particular could disrupt the status quo and create more fertile conditions for change. Of course, events can only help to open windows of opportunity for change; they do not guarantee success. The ability of innovators to exploit these events depended on the groundwork laid before the events occurred, be it the building of physical infrastructure, an evidence base, human capacity, or desire for change among the population.

While the electricity crises of the early 1990s in Manila were a key trigger for the chain of events that led to the privatization of electricity and water, the final shape of water privatization was heavily influenced by the technical assistance provided to the Filipino government by the International Monetary Fund and the French government, among others, and by administrators within government and the state water utility who prioritized access and inclusion goals in the regulatory framework.

A more recent example comes from the United States, where the 2008 financial crisis spurred changes such as the Dodd-Frank Act, which created the Consumer Financial Protection Bureau and other policies to protect against predatory financial practices, but this built on advocacy efforts going back several years by groups including Americans for Financial Reform and the Center for Responsible Lending.

What About Norms?

We have spent much of our time here discussing the formal rules that govern a market, but behaviors in the market also conform to norms, i.e., informal standards that govern behavior in a society. We might think of norms around appropriate gender roles or the relationship between different ethnic groups. Although these standards are unwritten, and therefore more difficult to discern and analyze, they can be as powerful as codified laws and regulations.

In Gujarat dairy, our analysis revealed that norms were a significant force in shaping the market and that changes in these norms helped the market progress toward inclusive economies goals. This was most clearly demonstrated in respect of caste inclusion in the dairy cooperative model. Caste-based discrimination was prevalent in Gujarat in the 1940s when the cooperatives were established: Cooperative societies were typically controlled by the upper and middle castes, and those from lower castes were often excluded from membership and sometimes even from selling milk at all. A gradual loosening of attitudes from the 1960s onward resulted in the expansion of cooperatives to include farmers from lower castes. Today, systematic exclusion on the basis of caste is no longer a significant issue in Gujarat dairy cooperatives.

We also saw how social movements that grew out of changing societal norms could be the launch pad for new business innovations. In the United States, community development finance institutions (CDFIs) are known for having pioneered new practices in reaching low-income groups and racial minorities with formal financial services such as bank accounts and loans. What is less well known is that CDFIs emerged from the civil rights movement and were formed specifically to combat the practice of “red-lining” in which mainstream banks drew red lines around certain minority-dominated neighborhoods on maps and excluded those areas from their services.

In some of our cases, we saw that norms shifted in ways that were not purely local but instead were linked to an international dynamic. In Costa Rica, the early ecotourism business pioneers saw themselves as part of the international counterculture; one pioneer entrepreneur explained that the idea of ecotourism arose from the “search for profound and enriching experiences that characterized the decade of the sixties.” From the 1980s onward, strengthening international norms around environmental stewardship then drove demand for ecotourism as more people around the world became increasingly concerned about the loss of biodiversity and natural habitats and more interested in experiencing destinations where these assets were still abundant. As a result, businesses offering ecotourism products widened out from a small niche serving the scientific community to large operators catering to a more mainstream market.

In cases where positive consumer norms were converted into pressure on businesses, we also observed the importance of mechanisms that helped to build and sustain that pressure over time. These were mechanisms that helped to reduce the information asymmetry between consumers and businesses and encouraged consumers to make an informed choice in greater numbers in order to exert stronger pressure on businesses. In the case of Colombia coffee, growing international consumer concern over environmental and socio-economic impacts led to the growth of a new specialty coffee segment addressing those issues. But it is sustainability certification mechanisms (such as Rainforest Alliance) that have helped consumers make informed choices based on business sourcing practices and translate those norms into market incentives that guide business behavior.

Conversely, weak mechanisms can result in lack of pressure to sustain behaviors that conform to those norms. In Costa Rica, the impact of the government’s Certificate of Sustainable Tourism (CST) scheme has been limited by a number of factors including low levels of participation by hotel operators in the scheme, and the fact that CST information does not typically appear on the travel booking websites increasingly popular with tourists. It is therefore unsurprising that, as ecotourism continues to become more popular and the market becomes more competitive, reports of greenwashing—where operators claim to follow ecotourism principles but do not actually do so—are also on the rise.

SIDEBAR: Addressing Multiple Dimensions of Inclusive Economies

We introduced the concept of a multi-dimensional framework for inclusive economies goals in “The Progress of Markets”, and our in-depth case studies all exhibit progression on several fronts, not just one. If we relate this to our analysis of market system innovations, we also see that it is the *combination* of those innovations in any one case that helps shape market evolution toward a balance of outcomes.

Take the example of Costa Rica. A range of innovations from civil society and the public sector in the late 1960s and early 1970s resulted in stronger environmental protection laws and the creation of a National Parks system. These were then complemented by the growth of new ecotourism businesses in the 1980s (such as eco-safaris and boutique eco-lodges), the launch of a new hotel sustainability rating in a popular travel guide, and a decision by the government to brand Costa Rica as an ecotourism destination as it continued to expand the network of protected areas. The combined effect of these innovations began to reverse Costa Rica’s trend towards deforestation in the 1980s. Since then, forest cover has doubled, and poverty levels around protected areas have declined significantly. In this case, a sequence of mutually reinforcing innovations led to market shifts that produced a combination of results around growth, sustainability, and participation.

In the Colombia coffee market, innovations from different parts of the system have also led to changes in the balance of results over time. Innovations by the FNC (e.g., purchase centers, improved coffee strains, the “Juan Valdez” brand campaign) and the government (e.g., coffee export levy, land reform laws) came together to support a market that emphasized increasing *participation* by farmers across more areas, *growth* in terms of output and commercial value, and *equity* in terms of the share of value flowing back to farmers.

A stronger focus on sustainability only came in toward the end of the century, as international consumer norms around ethical consumption and certification schemes such as the Rainforest Alliance came into the picture. Meanwhile, growth in the early 21st century has been driven not by the FNC, but by new smallholder associations independent of the FNC that have tapped into growing demand for specialty coffee.

One implication of this is that while individual innovations are important, what is even more important is how they act in concert to help shape the system’s evolution. Another is that no one actor within the market system is likely to innovate on all dimensions of an inclusive economy, if only because there is unlikely to be any one actor that is strongly motivated by all of them, e.g., someone focused on equity and growth may not care deeply about sustainability. As such, in engaging with market system innovations, we should therefore be wary of expecting any one actor (such as an impact enterprise, or a government agency) to work across *all* the aspects of an inclusive economy that are of interest.

Section 3. Harnessing Market System Innovations

Based on our in-depth research and analysis, we propose a new approach for funders and intermediaries interested in helping markets advance toward inclusive economy goals. These may be actors mainly focused on market-based solutions that are beginning to engage with wider ecosystems, or actors already deeply involved in work with market systems—our own teams at FSG and the Rockefeller Foundation have inhabited the continuum between these two points over the past decade. In some ways, what follows is the approach we ourselves intend to adopt, and we invite others to explore, test, and refine the Market System Innovations (MSI) approach together with us.

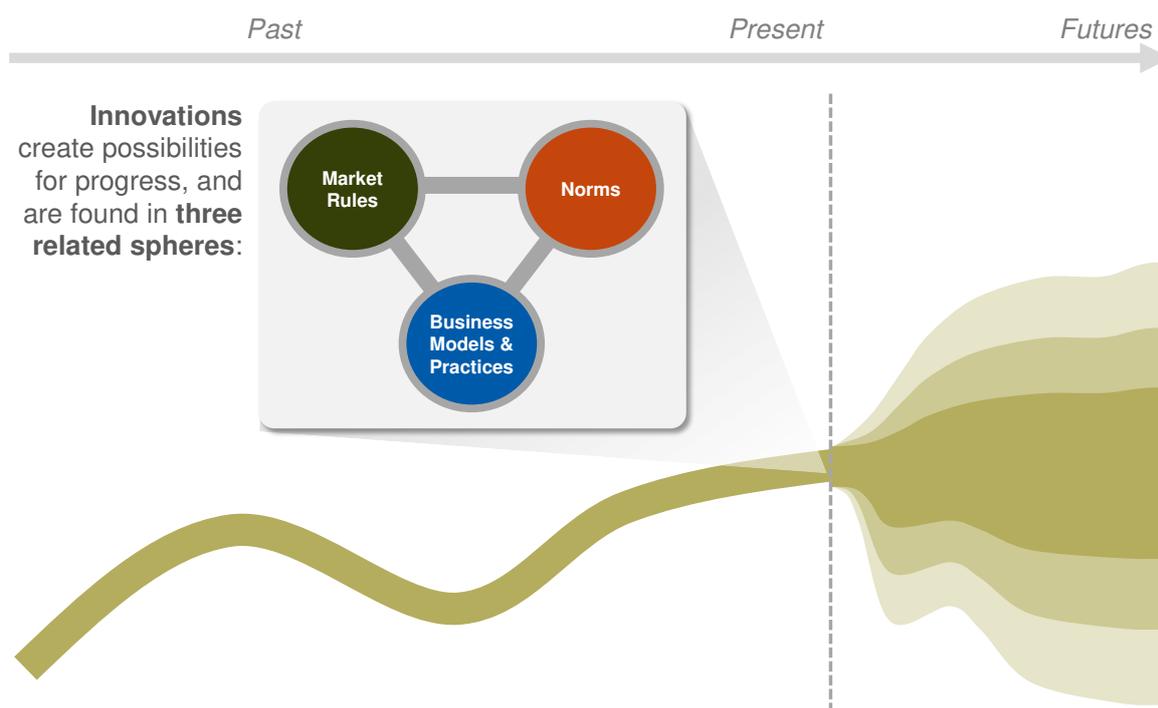
Introduction to the MSI Approach

The MSI approach is based on the understanding that innovations within the market system create possibilities for market progress, and that these innovations are found not only in relation to business models and practices, but also in the spheres of market rules and norms, because these govern the behaviors of market players. As such, relevant innovations and innovators might be found not only in the private sector, but also in the public sector and in civil society.

Inspired by the long arc of change in each of the case studies, this approach also acknowledges that the market systems we engage with have already been evolving and will continue to evolve. When we approach a market system, we should not think that we are bringing change to an otherwise static system. In reality, we are joining a system in motion, at a point on its journey, and with a range of possible future paths and outcomes. Certainly, we should not fall into the trap of believing that the first day of our intervention is also the first day of change for everyone else in the system.

In essence, the MSI approach is oriented toward continually seeking out the innovations that hold the potential for changing the system and supporting and harnessing those that help the market evolve toward a future defined by greater inclusion (see Figure 5).

Figure 5: The Journey of a Market System, and Market System Innovations



We must also recognize that market systems, like all social systems, are characterized by *complexity*, meaning that patterns of cause and effect cannot be predicted with confidence in advance. Instead, changes in these systems are the result of the interplay between multiple independent factors that influence each other in ever-changing ways.

Because of this, a perfect strategy for market system transformation is unlikely to be designed at the outset of any planned intervention. Approaches that rely solely on up-front analysis to determine a strategy, together with a fixed set of activities to be implemented and targets to be met, are ill-suited to market systems work that requires flexibility, adaptability, and continuous learning.

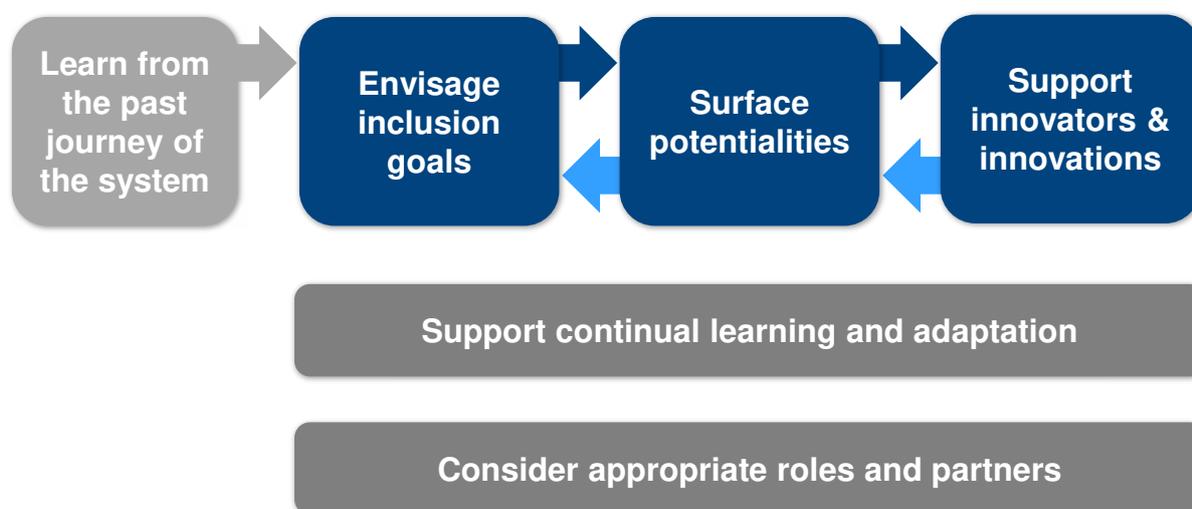
Instead, the MSI approach requires us to respond to an evolving reality where new opportunities emerge, setbacks occur, and hypotheses about how to effect change will have to be revised as funders and intermediaries engage with the system. This requires an iterative approach, where strategies and goals are continually refined as we better understand the system and as the system itself evolves. It is important, therefore, that these efforts are underpinned by a set of mechanisms and a culture within our own organizations that support dynamic learning and adaptation.

The MSI approach is intended to allow funders and intermediaries to *continually* deepen their understanding of the market system, and make informed decisions about where and how to act to help the market system evolve toward more inclusive economies.

Overview of MSI Approach

An overview of the elements of the MSI approach is shown in Figure 6.

Figure 6: Elements of the MSI Approach



Before engaging with the market system, we must **learn from the past journey of that system**. If we are joining the system on its journey, we can only be effective by knowing where it has journeyed before we arrived; understanding its past helps interpret the present and be more adept at influencing its future. What can we learn from how the system has changed in the past? What can we learn from past attempts to change the system that did not succeed? What forces predominate in shaping the market system? Are there any clear trends that could help us, or work against us? We see learning from the past journey of the system as a foundational activity that informs all other elements of the approach.

We then see three inter-related areas of decision-making and activity related to our actual strategy of engagement with the market system.

First, we need to **envisage the aspects of economic inclusion that we wish to see in the market system**: What is the desired future we would like to help realize? Importantly, this process should take into account the multi-dimensional nature of economic inclusion, using a framework such as the inclusive economies framework introduced at the beginning of this report. The key is to minimize our blind spots so that we are not making unintended omissions or causing unintended harms while also focusing on certain dimensions of inclusion that are relevant both to our mission and to the market’s current situation.

Second, we need to **surface the potentialities in the market system** that could help it advance toward the inclusion goals we envisage. Merriam-Webster defines a potentiality as “a quality that can be developed to make someone or something better,” as well as “a chance or possibility that something will happen or exist in the future.”⁶ Both of these meanings are relevant here: Certainly, these potentialities represent possibilities for a different future, but they also reflect qualities within the system that could be enhanced or amplified in order to drive greater inclusion. In our approach, surfacing potentialities involves not just identifying a potential improvement, but assessing where it is on its journey toward realization and impact as this will help us understand what the system might need to fully realize the change.

⁶ Merriam-Webster’s Dictionary, <https://www.merriam-webster.com/dictionary/potentiality> (May 9, 2017).

Third, we need to **seek out and support the innovators and innovations** that are relevant to the potentialities surfaced. We would want to understand who and what could advance the potentialities, as well as how they would best be supported.

It would be easy to read the three areas described above as three linear steps—we first define goals, then surface the potentialities that could get us there, then support the actors that align with that—and of course they are very likely to be used in that way.

However, we could—and should—also use them in the other direction. For instance, when we are deeply engaged with innovators, we might learn things that cause us to reframe our sense of the system's potentialities. We might even move back up to our goals, refining and sharpening them based on our improved understanding of how the system is changing. This allows us to keep moving toward our overall vision for market transformation while continuously reflecting in our choices and actions the opportunities and challenges that are emerging in the system.

This is intentional, and critical to the whole approach. As described before, it is not possible here to fix a strategy up-front and then somehow make the market system conform to it. What should take place is a process of progressive engagement, discovery, and adaptation.

Supporting these efforts are two key underpinning elements. One relates to **organizational frameworks and systems that focus on continual learning** and therefore support the iterative and adaptive aspects of the work described above. The other is about carefully **considering our own ability to anchor support to the market system**. Do we have the local presence, knowledge, and networks required for the deep engagement that is necessary? Or should we consider working through a primary partner organization that can serve as the local anchor for our work?

These elements of MSI can be applied in multiple ways by funders and intermediaries with different starting points and scope for engagement. In some cases, existing programs may have a market system as a focal point, while in others, multiple markets may be in the frame (e.g., if working to improve livelihoods in a particular region, multiple crop markets could be within scope). In the latter's case, many of the modes of inquiry and approaches related to inclusive economies outcomes and needs of the system can allow a deeper analysis about opportunities and trade-offs in achieving transformational change.

For example, if we need to select a few countries within a region to focus efforts in, we could use a multi-dimensional assessment of inclusive economies outcomes to assess where the needs of the system correspond with our mission as a funder or intermediary. We could also surface potentialities and identify relevant innovations in order to understand whether the nature of support required fits with our own assets and capabilities.

In some cases, we may have the opportunity to start from scratch and determine the market system in which there is both need and opportunity for change and alignment with the organization's mission or strategic priorities. Determining where to focus will depend on each organization's set of values, goals, and assets and could include the following considerations:

- What are the geographies in which we operate as a funder or intermediary? Do we have a particular focus on municipal, regional, state, or country levels?
- What are the dimensions of economic inclusion that are aligned with our mission?
- Within these geographies and issues, are there particular markets where we have expertise? Which markets are important factors in the lives of marginalized producers or consumers?
- What are the boundaries of these potential markets?
- What is the opportunity and need in these potential markets?

This analysis is performed to help us narrow the list of markets where we will invest but is not intended to provide us with the full picture of the need and opportunities that we will be trying to address.

In the rest of this section, we will go deeper into elements of the approach and describe how we as funders and intermediaries could put them into action.

In Practice: Defining the boundaries of the market system

You are about to begin a new initiative with the broad objective of advancing more inclusive economic outcomes in agricultural markets in a country, but have not yet defined the boundaries of the system in which to support change. You've invited your team for a strategy session to think through how to define these boundaries as an initial step prior to implementing the MSI approach. Below are some principles and considerations that you could ask your team to reflect on before the session:

Principles:

- **A market system consists of multiple elements.**⁷ At its core, a market system consists of buyers and sellers in a good or service, of course. But it also includes wider value chains and supporting activities that enable transactions in the core market (e.g., skill development to produce the good, banking services to finance purchases, platforms that allow buyers and sellers to interact). The market system also encompasses the formal rules (e.g., employment laws, quality standards, environmental regulations) and the informal norms that influence interactions and outcomes in the system (e.g., gender norms, attitudes toward race).
- **There will always be inter-related and adjacent systems.** In reality, all systems and sub-systems will be inter-related in important ways. For example, even if you define your system boundary as relating to three crops in four states, the system defined will be affected by events and actions occurring at the national level (such as national government policies) or changes in the market for other crops (such as a fall in demand for a competing crop). You should consider these wider relationships when you define the market system. This also means that, while it is important to define boundaries at the outset, new connections may emerge over time as you engage with the system and you may have to refine the boundaries you have drawn.
- **Some trade-offs will be necessary.** You will have to make some choices and trade-offs when defining the boundaries of your system. The wider the boundary that you define (for example, the national rather than the subnational level), the more likely that the effort and investment required to achieve significant changes will be greater, but the potential for impact at scale is also greater.

Some important considerations:

- **Mission and goals:** What boundaries of the market system would align most closely with your mission and goals? For example, does your mission require you to take a national approach, or can you define the system boundaries at a sub-national level? Are your goals (such as numbers of lives impacted) defined in such a way that you are required to work across multiple crops to meet them?
- **Capabilities:** Do you have deep knowledge of particular regions of the country, or deep expertise in the value chains of particular crops? Are your networks stronger at the national level (for example, with the central government and pan-national corporations) or at the local level (for example, with particular state governments and more local market players)?

⁷ We recommend the *M4P Operational Guide* (The Springfield Centre, 2015) for readers interested in more detailed explanation of the different parts of a market system. Details of this and other recommended resources can be found toward the end of this report.

Do you have the resources to effectively support systems defined to include multiple crops, or would you be more effective if you concentrated resources on fewer crops? Do you have the capability and resources to work effectively in multiple, more narrowly defined systems within the country?

- **Geographic diversity:** How significantly do the elements of the system vary as you move across different geographies within the country? Are the formal rules primarily set and implemented by the central government, or are they controlled by the state? In the latter's case, you may want to define your system in terms of a particular state as the rules that you wish to influence will be unique to that geography. Similarly, if important norms are likely to vary significantly by geography, you may consider defining the boundaries of the system to reflect this variation.
- **Overlaps in market system elements:** How different are the value chains for the different crops you are considering? Do several of these crops have very similar value chains with significant amounts of overlap? For example, are there some crops for which collection, processing, and distribution are done by the same market players? Are the farmers producing these crops governed by the same formal rules? The greater these similarities, the more feasible it might be to define the system boundary to include these crops.

I. Learning from the Past Journey of the System

Before designing a specific intervention for the selected market system, it is important to understand the long arc of change through which the system has already traveled. While many funders and intermediaries are increasingly practiced at mapping and understanding the system as it stands today, rarely do they dedicate space and time to looking into the past to observe how the system has already been changing so that they can better understand the current moment in the system's journey.

Although complex systems are not predictable, it can be very helpful to understand past patterns, trends, and forces that could continue to influence current and future developments. For instance, certain actors, relationships, processes, and events may have consistently contributed to positive or negative outcomes from an inclusive economies perspective over time. Understanding these patterns can help practitioners to avoid some of the pitfalls of the past and better recognize opportunities that may succeed. It will also provide the context necessary to understand the current state of equity, sustainability, participation, stability, or sustainability in the market system. Why has there been progress or regression? What are the forces that have traditionally supported advancement or thrown up obstacles? How have these different aspects of economic inclusion evolved in relation to each other?

The significant areas of inquiry to pursue in the historical analysis should include:

- How have aspects of economic inclusion evolved over time?
 - Which outcomes moved together? Which ones were in tension with each other?
- How did these shifts correspond to changes and innovations across the spheres of
 - Business models and practices?
 - Market rules?
 - Norms?
- How and why were these changes achieved?
- Were there periods where change seemed in prospect but failed to be realized? How and why did this happen?
- Who were the actors and innovations involved, and how were they related to each other?

- What were external trends, forces, and events that helped drive or limit change?

Historical analysis can draw on desk research as well as interviews with actors and observers who have a long and deep history of engagement with the market system. The key is to try to understand connections between different elements in the past journey of the system; as such, it can be helpful to apply tools such as timeline mapping and actor mapping when doing this work.

II. Envisaging Inclusion Goals

Naturally, an important step in beginning to engage with the market system is to **define the overall improvement that we wish to see in the market**. This vision for the market will serve as a compass that guides us as we continually refine and sharpen our more specific goals for the system.

Our historical analysis provides a basis for seeing the ways in which the market may be improved. It can reveal areas where the need is greatest, and the ways in which the system may have changed in the past. We can also draw on our experience in the sector, either in the same market system or more generally, to project ways in which a market could move to arrive at better outcomes. For example, we might envisage a further transformation of the Gujarat dairy market from one where environmental consequences are largely ignored to one where the businesses operating in the market contribute positively toward environmental outcomes.

Once we have our overall vision defined, we would then need to **sharpen our goals for changes in market outcomes**. Central to this is an appreciation of the multi-dimensional nature of economic inclusion as described in the Rockefeller Foundation's framework covering aspects of growth, participation, equity, sustainability, and stability. While it is not necessary to adopt the framework we have used, we do believe that funders and intermediaries should consider the full range of dimensions and outcomes relevant to their mission and values and work hard to minimize blind spots.

Considering all relevant dimensions of economic inclusion can help us to have a fuller and more nuanced understanding of the opportunities, trade-offs, and consequences of potential approaches. For example, in thinking about how to improve sustainability in the Gujarat dairy market, we might address the following questions:

- What are the equity implications of the proposed goal and the changes that could support it? For instance, will the new technologies needed to reduce water usage favor only those groups who can afford the up-front capital expenditure?
- Could growth be threatened if sustainability measures affect the overall competitiveness of Gujarat dairy producers? How could growth goals be met in the near term while also accounting for longer-term sustainability objectives?

It is important to note that while we should always begin with defined goals, these will necessarily be refined and sharpened over time as we learn more about the system's potentialities and engage with innovators.

In Practice: Agenda for an Outcomes Discussion with a Program Team

You have the results of your historical analysis and now you want to engage your team in thinking through possibilities to support transformation in the chosen market system. Now what?

A sample agenda of how to run such a meeting is provided below.

- **Goals (2 hours):** Based on the historical analysis and your organization's vision for market transformation, you will likely have a general sense of the priority areas. You will want to ask your team to review the historical analysis and reflect on the transformation vision in advance so they come prepared to react to goals and brainstorm a range of potentialities that could help

achieve them.

- **Opportunities from other dimensions (1 hour):** Once you have established a preliminary set of goals and desired changes you could ask the team to think about how they might revise them from the perspective of other dimensions to make them more effective or to mitigate risks. Some of the suggestions that emerge may not result in a revision of the goals or desired changes but could be helpful considerations for the research and future discussions about the types of innovators and innovations to support across the system.
- **Trade-offs and blind spots (1 hour):** In this section of the discussion, the team members will be asked to help them think beyond their usual mental frame—perhaps only focusing on equity or stability—to consider the range of unintended consequences, trade-offs, and blind spots of a given pathway. There may be a design solution for the issues that are raised, but some may require the team to make difficult decisions about where to prioritize their efforts in the short term.

III. Surfacing Potentialities

The next part of the MSI approach is to identify potentialities within the system that can make progress toward defined goals and determine how close they are to being realized.

Potentialities are possibilities for change, as well as qualities that can be developed to make something better. In the context of market systems, they can be thought of as the pathways or means within the system through which goals could be realized. These potentialities may exist in all three spheres of the market system: business models and practices, market rules, and norms. For example, if our goal is to improve sustainability in the market in terms of reduced water use, potentialities for realizing this might include new water-efficient business models, a formal market rule that compels better stewardship of water by businesses, or effective norms relating to the way water is valued.

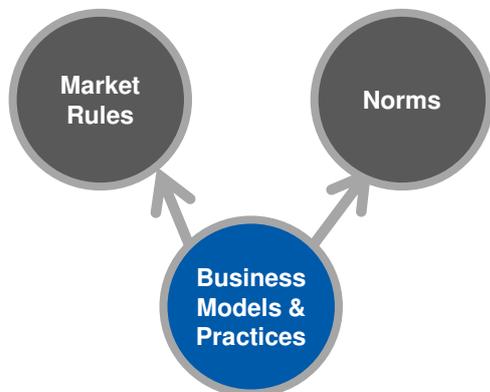
Multiple potentialities could exist in each sphere. Each potentiality in turn can be advanced by several different innovations and innovators.

We should support potentialities that align most closely with our vision for transformation and goals, and, to the best of our ability, determine which have the greatest chance of success. Initial judgements about which potentialities are most promising will be based largely on our analysis and understanding of the particular market system: They are educated guesses about the ways in which we could support the achievement of our goal. Should we pursue a potentiality around adoption of new practices by existing corporations, or should we back radically new business models? Should we support rule changes that compel businesses to adopt new practices or ones that favor those who voluntarily adopt them? As we learn more about the system over time, these judgements will be clarified, sharpened, and refined in an iterative manner.

Strong interrelationships exist between the three spheres of the system. New business models could, for instance, gain greater traction if accompanied by a rule change that favors the business, or by the spread of supporting environmental norms. Focusing on these interrelationships and harnessing complementary potentialities across the three spheres is a key part of MSI practice. Figure 7 below provides an illustration of how we might seek out complementary potentialities in different spheres.

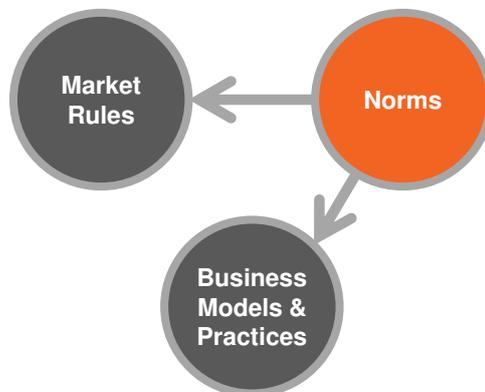
Figure 7: Pursuing Complementary Potentialities Across the Three Spheres

We could **start with a potentiality in the business sphere** and then look for shifts in norms that would support it, and changes in rules that would favor it



Example: Begin by identifying radically new business models as having potential for driving sustainability improvements in household waste management, then look for potential for shifts in norms that would make households more likely to recycle and changes in rules that would reward households that recycle

Or we could **start with a potentiality in the norms sphere** and look for businesses that could leverage it, and changes in rules that would favor it

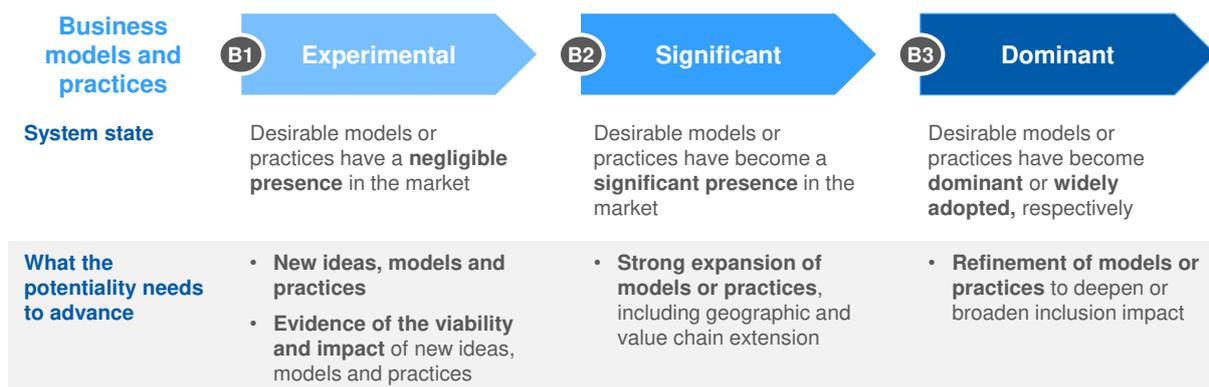


Example: Begin by identifying a norm of environmental consciousness among the public as having potential to drive sustainability improvements in household waste management, then look for potential business models that could leverage this new norm and changes in rules that could compel businesses to adopt sustainable practices

Phases of Change

However, it is not enough to identify the potentialities themselves. Because they go through various phases of change on the path to realization, we also need to **locate where the potentiality is in this process of change**. Knowing this will allow us to better determine the type of support needed to help the potentiality advance and on which potentialities we should focus.

Figure 8: Phases of Change for Potentialities in the Business Sphere



Potentialities in the business sphere relate to the business models and practices that could help the system move toward our inclusion goals. Figure 8 outlines the phases of change in the business sphere as well as the particular needs that should be met for the potentiality to advance.

Change in the business sphere is evolutionary in nature. New models and practices go through an early stage of experimentation and validation before they begin to be adopted by market players. Even after becoming a significant presence in the marketplace, new models may take time to grow and gain market share as customers and suppliers are won over time in a competitive market environment.

In contrast, changes in market rules can sometimes appear to be more abrupt as significant rule changes can occur within relatively short periods of time. For example, a new law that bans environmentally unsustainable practices could be proposed and passed within a matter of months and come into effect overnight. However, these rule changes are often preceded by periods of important activity that build toward change itself. For example, years of patient work in developing policy proposals, gathering evidence, and conducting advocacy preceded the passage of the 1969 Forestry Law in Costa Rica and the subsequent establishment of a network of protected areas across the country.

Figure 9 shows the phases of change for market rules, indicating how a potentiality around market rules could advance from being dormant to a situation where there is increasing pressure on rule makers to enact change and then—after a formal rule change—to consolidation of that change as pressure around the issue begins to dissipate. It also shows what the potentiality needs in order to advance: For instance, the nature of support required when pressure for a rule change is intensifying is different from what is needed when the rule change has been achieved but has to be translated into impact on the ground.

Figure 9: Phases of Change for Potentialities in the Market Rules Sphere

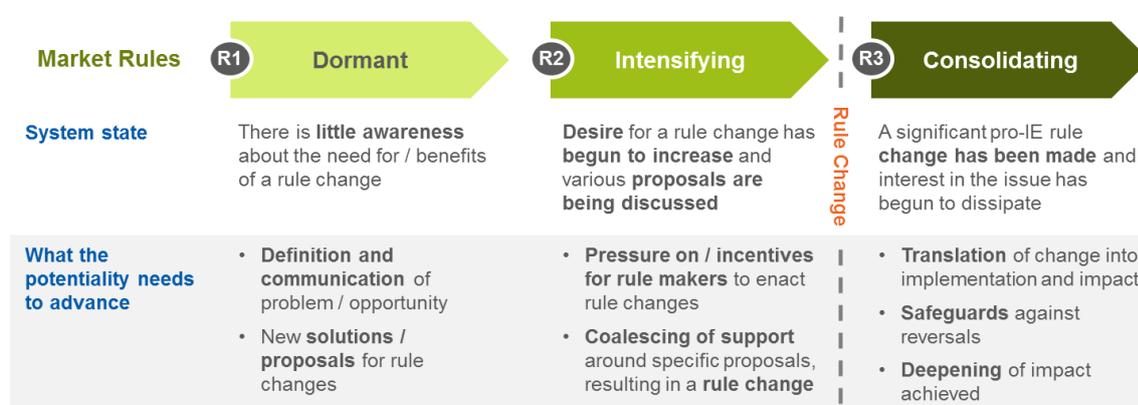


Figure 10 shows the phases of change in the norms sphere, which are defined by how widely accepted the norm is, and therefore the degree of pressure it can exert on market players. If the potentiality is a new norm around household waste recycling, for example, is this something that is accepted by a small minority and can therefore be easily ignored by market players? Or has it strengthened to an extent where a significant share of consumers care about it and some market players see a business opportunity in catering to it? Change in norms is usually a gradual process as new norms are seeded and slowly win acceptance within society over time.

Figure 10: Phases of Change in the Norms Sphere



Determining the phase of change a potentiality is in can also help us set more reasonable expectations about how long it could take for our goals to be realized. Better understanding these timelines can help

us make judgements about which potentialities fit with our organization's principles and approaches. For example, are we comfortable with seeding new ideas that may take longer to come to fruition, or would we prefer to consolidate existing progress?

It is possible that in some systems, none of the potentialities in any of the three spheres are in a phase of change that makes sense for our organization to support. In these cases, we may choose to continue to wait for a suitable potentiality to emerge or refine our immediate goals to better reflect the existing potentialities. Efforts to surface potentialities that could help realize our original desired changes may continue in parallel even as we act on more immediately feasible potentialities. For example, if there are business models that could radically reduce the space required for pasture or feed crop production, but none that could address water usage or emissions, we could refine our goals to reflect the potential of the existing business models while continuing work to identify potentialities that could address water usage and emissions. In some situations, we might choose to disengage from the market and support a different market system where the potentialities align better with our interests and capabilities.

The diagrams above present an ideal, linear path of change; in reality, the process of change is likely to be less straightforward. For example, efforts to realize a particular rule change may face setbacks, and the process may reverse from Intensifying to Dormant as pressure for change ebbs away. There could also be multiple cycles of change over time, as seen in our case studies. Different business models and practices might emerge and grow to dominance at different times, and different market rules might come into force. The diagrams above are presented in a simple linear format in the interest of simplicity, but they should not cause us to think that movement toward economic inclusion is a one-time effort: We might think about helping a market system progress from A to B, but even if it does arrive at B, it will continue to evolve to C, D, E, and so on.

Analysis, Sensing, and Probing

There are three complementary and iterative approaches to discerning potentialities and the phases of change: analysis, sensing, and probing.

- **Analysis** of existing documentation and data relating to the specific change is perhaps the most obvious approach. For instance, analysis of a potentiality around business models and practices could include indicators relating to current market share or level of adoption, growth rates relative to other models or practices, levels and trends around investment, or the nature of related innovations that are occurring. Meanwhile, in the sphere of market rules, one might analyze the level and nature of media coverage on particular issues or the content of political manifestos, speeches, and policy consultation papers.
- **Sensing** involves listening for and observing changes and patterns, because analysis of documented data only provides a partial picture of the system. For example, a certain policy may exist on paper but is not executed in practice. A key part of understanding the reality of any market system is to engage with and listen closely to a large network of actors embedded within the system, who have a robust longitudinal perspective on the system and have their “ears to the ground.” Effective sensing is a capacity that is cultivated over time: It requires an ability to have an open mind about what we will find through the process of sensing, and shedding pre-existing biases and preconceptions to the greatest extent possible.⁸
- **Probing** the system by experimenting with initial interactions or actions is often necessary to complement and test findings from sensing. For example, when sensing, we may be told by a vast majority of individuals that there is support for a rule change, but it could be that there are conflicting judgements. Probes allow us to observe and assess what happens in response to a specific action and so learn more about where the system is and how change could be achieved.

⁸ We recommend Otto Scharmer's book, *Theory U: Leading from the Future as it Emerges* (Berrett-Koehler, 2009), for its guidance on effective sensing, among other relevant practices for working in systems.

In Practice: Techniques for sensing and probing to discern the phase of change

Your analysis of the likelihood of a rule change suggests that it is in the Intensifying phase, but you would like to sense and probe to gain further clarity on this. How might you do this?

- **Sensing:** Reach out to a network of people who you feel have a strong sense of how likely the rule change is. Make sure you include people from various sectors and who you might expect to have different perspectives on issues. Civil society activists, journalists, academics, business leaders, and politicians from parties both within and outside government are some of the people you might consider. Try to build relationships where these individuals feel comfortable sharing their candid opinions with you.
- **Probing:** Probe by supporting the drafting of legislation that reflects the rule change. Ask a supporter within the legislature to propose it to his or her colleagues to see the response that it receives. A strong positive or animated response could indicate that the change is in the Intensifying phase,, whereas a very muted or dismissive response could indicate that the change is still in the Dormant phase.

IV. Supporting Innovations and Innovators

In “The Role of Market System Innovations,” we defined a market system innovation as follows:

A break from previous practice in its specific context, either radical or incremental, within the market system, that helps to advance market change toward greater economic inclusion, or mitigate risks in the market that could erode such inclusion.

The essence of a market system innovation is that it is a break from previous practice within its own specific context, not that it is necessarily new to the world; for example, the adoption of a practice that is well established in one country in a new market in a different country could be considered a market system innovation. Innovations are also not always radical; in many cases, they make incremental changes that advance the market system in small but significant steps. These innovations also occur within the market system itself. For example, a new technology developed abroad by unrelated inventors could not be considered an innovation for a particular market system, but the efforts of an actor within the system to connect to those inventors or import that technology could be. And because market systems continue to face risks and threats to inclusion as they evolve, innovations are as helpful at preserving gains made as at making them in the first place.

These innovations can occur in each of the three spheres of the system: business models and practices, market rules, and norms. Naturally, innovations within the business sphere can look and feel very different from those in the market rules and norms spheres. It is critical for us to be able to recognize and support innovations across all three spheres.

Figures 11, 12, and 13 below illustrate the different kinds of innovations in each sphere. This list is not intended to be exhaustive; it is a starting point that will be informed by the analysis, sensing, and probing conducted in the market.

Figure 11: Examples of Innovations in the Business Sphere

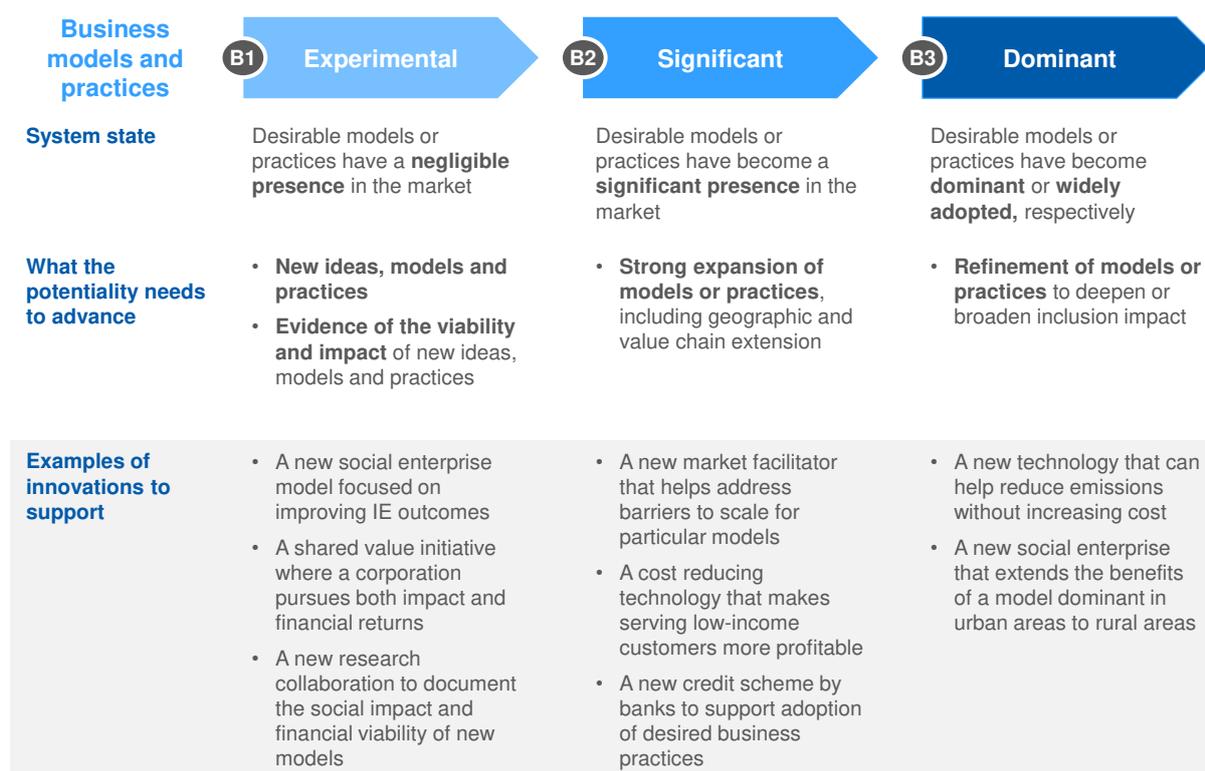


Figure 12: Examples of Innovations in the Rules Sphere

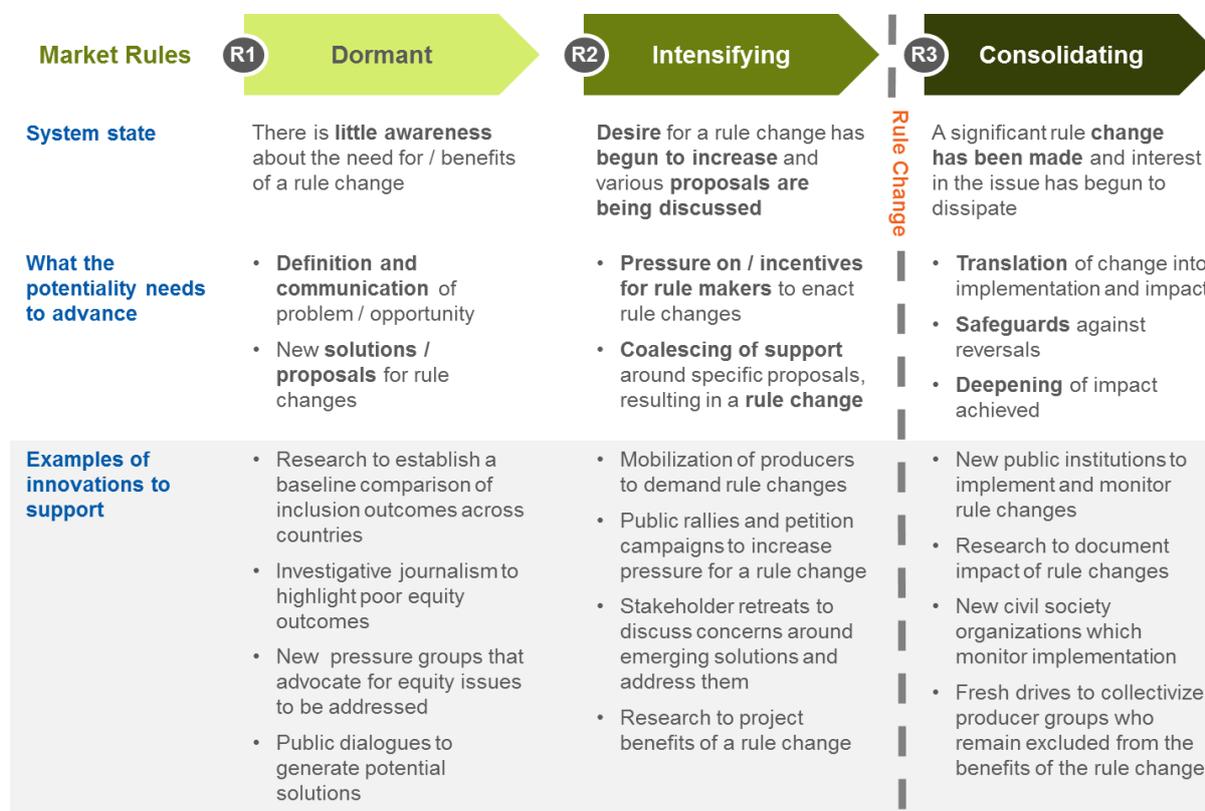


Figure 13: Examples of Innovations in the Norms Sphere



The Spectrum of Innovators

The diversity of market system innovations is reflected in the diversity of innovators who exist within the state and civil society as well as in businesses. In the market rules sphere, innovators within state structures—executive, legislature, regulatory bodies, and judiciary—can play a key role in advancing economic inclusion by breaking with practice in the state system to help bring about and implement rule changes. These innovators may be elected or appointed and may be extremely senior (such as presidents and governors) or civil servants who are motivated and willing to innovate within their sphere of influence.

The case of the Manila water market, for example, exemplifies the roles that can be played by both senior elected officials and civil servants: President Ramos was critical in terms of driving the overall privatization process while civil servants were instrumental in developing a privatization process that included measures to promote inclusive economies, such as the pro-poor performance metrics.

An example from current practice is offered by the Wadhvani Initiative for Sustainable Healthcare (WISH) in India. WISH engages with multiple levels of state government in order to support the scaling-up of innovative products within the public health system. They start by identifying senior officials, such as the Health Secretary and Chief Minister, who are open to making changes to rules that could significantly improve health outcomes. WISH also seeks out and supports civil servants within the health system who are willing to innovate in order to make adoption and operationalization of the products a reality.

The range of innovators within civil society is just as wide. Civil society innovators may come from a variety of professional backgrounds including academia, journalism, entertainment, community-based organizations, and faith groups. They may be considered among the elite of society or may come from the grassroots of their community. The case studies in this report illustrate the contributions of a number of civil society innovators in the evolution of market systems. These include academics in Costa Rica who envisioned, generated support for, and helped expand the nation’s system of protected areas, which serves as the backbone of the ecotourism industry. They also include grassroots activists in

Kenya, whose advocacy contributed to a smooth transfer of ownership of KTDA exclusively to smallholder tea growers in 2000, increasing their ability to influence decisions that affected their livelihoods.

An example from current practice of working with civil society innovators comes from The Asia Foundation (TAF), a nonprofit international development organization committed to improving lives across Asia. In the Philippines, TAF brought together a team of individuals from civil society, including a public intellectual, a retired government lawyer, a university lecturer, and a former investment banker, in pursuit of a common goal: reforming the land titling laws in the Philippines. The rule change that this team of civil society entrepreneurs was able to bring about helped increase the number of residential land titles issues per year by a staggering 1,400 percent.⁹

Leveraging External Events

A key theme that emerged from our case studies is how key innovators were able to exploit powerful external events, such as economic or political crises, to push through change. However, the capacity of those innovators to do so was always built up *before* the events occurred. The implication of this is that we should support the capacity building of innovators to prepare them to take advantage of significant events and be ready to step up or otherwise adapt our support when those events actually occur; developments may proceed rapidly in the wake of disruptive events, leading to new opportunities (and threats), or even moving the spheres of the system from one phase of change to another.

At first glance, it might seem strange or even unwise to have a strategy that hopes to leverage unpredictable future events, but history tells us otherwise. Disruptive events—such as political upheavals and financial crises—do occur, and the lesson from our case studies is that such events can help to create windows of opportunity for deeper changes in market systems, so we believe it is wise to bear this in mind as we support innovators within the system.

Finding Innovators and Innovations

Relevant innovators and innovations within the system may not be immediately visible. For example, it could be difficult to find the few civil servants within a large bureaucracy who are innovating in ways that relate to the potentialities we identify. Time and resources therefore need to be invested in the critical process of seeking out the right innovators.

Analysis, sensing, and probing once again provide complementary approaches for finding innovations and innovators to support. Sensing would involve conversations with those who have deep knowledge and could take the following forms:

- **Hosting Convenings:** Bringing together stakeholders to discuss trends and innovations. For example, Financial Sector Deepening Kenya (FSD Kenya), a special purpose market facilitation organization with a mission to advance financial inclusion in Kenya, has used convenings as a way of identifying actors who are interested in working on their issue areas and subsequently building relationships with those who innovate within the system.
- **Establishing and Tapping a Network of Experts:** Reaching out to individuals with a track record of being active around priority issues. For example, when looking to bring together innovators who could contribute to their overall objective of addressing weak property rights in the Philippines, TAF reached out to individuals who had previously demonstrated an interest in the issue area. These included a public intellectual who had been writing newspaper columns on property rights issues for some time and a retired lawyer who had worked on the issue during his time in government.¹⁰

⁹ Booth, D. (2014) *Aiding Institutional Reform in Developing Countries*, Overseas Development Institute.

¹⁰ The Asia Foundation (2011) *Built on Dreams Grounded in Reality*, The Asia Foundation.

- **Engaging “Unusual Suspects”:** Initiating exploratory conversations with individuals or groups who may have an interest in areas of focus, but do not necessarily have a track record of working on them. For example, holding meetings with various community-based organizations to see whether any of them have been concerned about, or are addressing, priority issues.

Probing is a more proactive approach to identifying innovations and innovators and can help indicate which actors in the system are most motivated to address a certain issue. Some examples of how we could probe the system for innovators and innovations include:

- **Testing Proposals:** Introducing actors to actual or proposed innovations to test their interest in supporting or adopting the innovation. For example, WISH hosted gatherings to introduce civil servants in the health sector to innovative products from the private sector, and through these was able to identify innovators it could work with within the state structure in order to get new products adopted and scaled.
- **Sponsoring Innovation Prizes:** Putting out a call for proposals to find potential solutions for priority issues. Open-ended calls for proposals, which do not restrict the types of ideas and innovations that emerge, are the most appropriate in these situations as they leave room for creative solutions to emerge.
- **Sponsoring Mentorships, Customized Trainings, or Fellowships:** Establishing short training courses or fellowships to attract people who have been working on priority issues or may be encouraged to do so. These would provide up-and-coming innovators with support as they develop their emerging ideas.

Innovations and innovators identified in one sphere could lead to complementary innovations in other spheres. In India, WISH identified a number of innovative healthcare products from the private sector that had the potential to drive improvements in efficiency and outcomes if adopted in the public sector. One of the challenges was that public procurement rules required at least three quotations for the same product, something that would not be possible for a novel product with only one supplier. Faced with this, WISH worked to actively identify and support innovators within the public system who then went on to bring about this rule change.

The identification of innovations and innovators is an on-going process. We should avoid limiting this effort to the start of an initiative or program, as new innovations and innovators who hold considerable potential will continuously emerge and innovations and innovators that show initial promise could fail as conditions and relationships continuously evolve.

As such, our orientation should be toward **placing multiple bets on innovation** in the system by supporting several different innovations and innovators simultaneously, within and across the three spheres. Consider each of these bets a probe that allows us to learn more about the system and the ways in which change could be realized in the future. Expect some of these bets to fail, and be prepared to deepen investments in those that gain traction in the system.

We should also ask which innovators and innovations we are most comfortable supporting and which best align with our capabilities? Are we more suited to supporting research to develop new hardware technologies or to helping to refine business models? Are we equipped to work well with activists and rights-based organizations conducting grassroots advocacy, or are we more comfortable supporting academic research that can subsequently be used by advocates? Every funder and intermediary must make their own choices regarding the types of innovation they choose to support but should remain cognizant of the need to harness innovations across all three spheres of the system in order to effectively support systemic change. There could also be potential to cultivate collaborative relationships (whether formal or informal) with other funders and intermediaries where there are intersecting interests with respect to a market system; these other actors might be able to support innovators and innovations that are relevant to a potentiality, but are not a good fit for our support.

In Practice: Placing multiple bets in the system

Below are some points to consider when developing your portfolio of bets in the system:

- **Alignment with vision for transformation and goals:** Determine the extent to which each innovation and innovator has the potential to contribute toward your overall vision and how each relates to your inclusion goals across multiple dimensions. For instance, an innovation might have the potential to promote growth in incomes, but what is its impact on the stability of those incomes?
- **Diversity within spheres:** You should ideally seek to place multiple small bets on innovations behind each potentiality. For example, rather than supporting a single impact enterprise model, you could consider supporting two or three, particularly in the early stages of your engagement with the market system.
- **Complementarity across spheres:** Prioritize supporting innovations and innovators that are complementary to each other across spheres. For example, if you are supporting corporations that are adopting a new business practice to reduce emissions, you could also support innovators working to change rules that would favor the new practice and innovations that could shift norms in favor of the practice.
- **Adapting and sharpening focus of investments:** Follow the progress of each innovation and innovator that you back closely, considering each of them a probe that allows you to learn about the system. Increase support of specific innovations that gain traction in the market system. Over time, the diversity of your portfolio may decrease, but it remains important to have some funds allocated to experimental grants that can provide a regular infusion of new ideas for the work.

How to Support Innovators

We should be ready to respond to the specific and continuously evolving needs of innovators. An innovator who initially requires only financial support and mentorship might eventually also need access to networks as he or she seeks to raise capital for the venture. An innovator working to change a rule may initially only require data that he can present to rule-makers but may later require support and guidance on building a broader coalition once opposition to the rule change begins to intensify. Four broad areas of support for innovators are described in Table 2.

Table 2: Areas of Potential Support to Innovators

Area of Support	Application Within the MSI Approach
Financial	Innovators will likely require funding to cover the practical costs of developing and implementing innovations. Financial support can also be important in terms of allowing innovators the security necessary to take risks, which, in some cases, could entail taking a break from their career. Importantly, financial support needs to be delivered in a flexible way that does not constrain the innovator’s ability to adapt to changing circumstances, threats, and opportunities.
In-Kind	This could range from providing data that informs the work of innovators to providing direct technical assistance and expertise to help innovators tackle complicated problems. For example, FSD Kenya identified weakness in retail capacity as the single biggest constraint to pro-poor financial market development. Its major intervention to address this was the provision of technical assistance to a small number of organizations, including commercial banks, to help them develop their retail capacity. This included support in operations, IT, marketing, product development, and human resource development.

Thought Partnership	Be a thought partner to innovators; share knowledge about the system and of similar markets. One of the key contributions of WISH, for example, has been its support to private entrepreneurs in understanding the machinery of the public health system and working with them to adapt products and business models to match the needs of the public sector.
Networks	The success of innovations and innovators can often depend on their ability to connect with and influence others in the system. This may be particularly problematic in the gaps between the private, public, and civil society sectors. It may also be more of a challenge for those working in environments where their kind of innovation is not highly prized, such as civil servants or corporate executives working in an institutional environment that is not attuned to their innovative efforts. In such situations, we could increase innovators' access to networks through convenings and other network-building initiatives.

Innovators could be supported as individuals or as groups and organizations. In our case studies, both individuals and organizations have been forces for innovation at different points. The MSI approach should allow the flexibility to support either as the need or the opportunity arises.

It is important to structure our support of innovators in a manner that provides the greatest degree of flexibility to adapt to changing conditions. Innovators in complex market systems will inevitably face setbacks that may not only delay when they can achieve certain milestones but require the milestones themselves to be revised. Traditional contracts with predetermined outputs, activities, and timelines are unlikely to be suitable in these situations. Rather, flexible grants are likely to serve both parties much better. These grants are based on a shared understanding of objectives, but keep specific work plans, activities, and outputs as only indicative, with a clear understanding that they will evolve over time.

It is important to acknowledge that this increased flexibility could present certain risks for funders and intermediaries, but they also hold the potential for being able to create much greater impact in the system; each will need to strike the right balance for themselves.

Certain measures could help mitigate some of these risks. One approach is relational contracting,¹¹ where the repeated nature of the interaction and the trust built over time can help reduce risk to some degree. TAF adopted such an approach in its land titling law reform efforts in the Philippines. Jaime Faustino of TAF held regular, in-depth meetings with both the frontline team they were supporting as well as with the program officer from the ultimate funder, USAID. These meetings were an opportunity to exchange ideas and build a shared understanding of the current issues, challenges, strategies, and activities. Trust is a critical element in relational contracting. As David Ferrand, director of FSD Kenya, put it: “I don’t see a way around the relationship between us and who we support being based on trust. We are dealing with massively incomplete information. The solution for that is trust.”

Sidebar: Development Entrepreneurship

The differences between innovators working on business changes and those working on rules changes are easy to imagine, but perhaps they have more in common than is often thought. Within the latter group are individuals that Jaime Faustino and David Booth call “development entrepreneurs” i.e., innovators who apply entrepreneurial logic to the process of reforming public policy, laws, and regulations.¹²

Faustino and Booth have described how such innovators share many aspects of their approach with business entrepreneurs, such as an acceptance of the resources at their disposal, recognition that setbacks are part of the process of finding the solution, and awareness that new developments and surprises can be turned into opportunity. Instead of linear thinking and long-term plans, entrepreneurs practice iterative “learning by doing”: They act, learn, adapt, and

¹¹ The Asia Foundation (2011) *Built on Dreams Grounded in Reality*, The Asia Foundation.

¹² Faustino, J., and Booth, D. (2014) *Development Entrepreneurship: How Donors and Leaders Can Foster Institutional Change*, The Asia Foundation and the Overseas Development Institute.

repeat in short cycles to continually improve their effectiveness. These development entrepreneurs innovate both technically and politically to influence their local system and help it move toward meaningful change.

This has implications for how such innovators should be supported. In some ways, it encourages us to think more like an investor supporting an entrepreneur, rather than a manager. We should orientate our funding and other support toward results and learning, rather than activities. We should avoid over-specifying *how* results should be attained and resist any tendencies toward asserting control over the entrepreneur's decision-making. In identifying such innovators, we should also consider both technical and political aspects of their capability and ensure that they have a high level of motivation to pursue their reform agenda.

V. Support Continual Learning and Adaptation

All of the steps described above assume that an organization has the capabilities needed to be adaptable in situations where change is likely to be idiosyncratic. But many funders and intermediaries are locked into predictive models of strategy that are executed on fixed timeframes. Rigid logic models do not allow for the type of flexibility that is needed to adapt in the face of the dynamism of ever-evolving systems. In the context of market systems, logic models have led funders and intermediaries in the past to place safe bets, closing the door to new innovations and circumstances that may be bubbling up in the system.

What is needed instead is a view and practice of strategy as *emergent*. As described by FSG colleagues, “An emergent strategy gives rise to constantly evolving solutions that are uniquely suited to the time, place, and participants involved.”¹³ This does not mean that organizations should discard a focused and strategic approach. Rather, emergent strategy relies on clear goals and intent, while recognizing that specific pathways and outcomes cannot be foretold with precision. Put another way, we can have a reliable compass that always points us to our desired ultimate destination while being open to revising the routes on the map that might take us there.

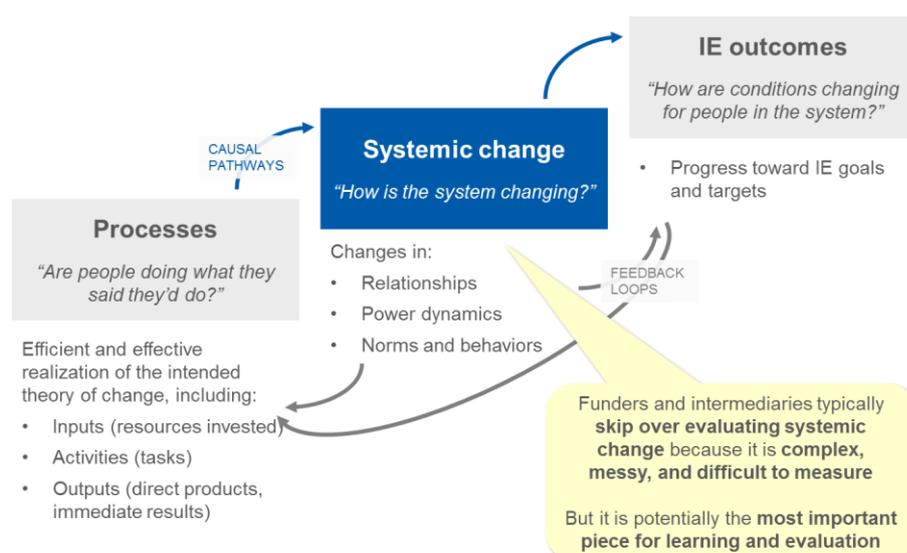
The MSI approach falls within this broader approach to strategy: We will need to take an iterative approach that embraces the complex nature of systems change while remaining focused on the overall vision for how a market system can be transformed toward more inclusive economies.

Monitoring, Evaluation, and Learning

One critical aspect of working in this way is our ability to perceive and understand changes in the system and adapt our work accordingly. While most funders and intermediaries have embraced the importance of monitoring and evaluation (M&E), in practice, most organizations' efforts remain focused on ensuring accountability for the resources invested. As a result, they tend to track tangible, often quantifiable data points such as inputs, outputs, and, to some extent, outcomes. These activities offer organizations useful information about *what* is happening, but they do not give us enough information to understand *why* things are or aren't changing. Without this information, it is challenging for us to learn specific lessons or determine, with confidence, how to adapt what we are doing.

¹³ Kania, J., Kramer, M., and Russell, P. (2014) “Strategic Philanthropy for a Complex World”, *Stanford Social Innovation Review*.

Figure 14: Elements of an Adaptive Monitoring and Evaluation System



Efforts to advance more inclusive market systems require us to adopt a more robust and flexible approach to M&E that accounts for the complexity of what it takes to change systems. For example, as illustrated in Figure 14, funders and intermediaries should pay careful attention to the changing relationships between different actors in the system, the power dynamics that are reflected in those relationships, and different stakeholders’ perspectives about relevant relationships in the system (e.g., a smallholder farmer, bank executive, and civil servant all experience the system, and the rules and norms that shape behaviors, differently). While these dynamics are difficult to capture and describe, and may be impossible to quantify, they are critical to our ability to understand—and therefore respond to—changes in the systems we seek to influence.

In *Evaluating Complexity: Propositions for Improving Practice*, FSG colleagues outline the ways in which M&E should adapt to generate effective, actionable information about complex systems, as summarized in Table 3 below.¹⁴ Complex initiatives require a more continual stream of information about what is happening and to what effect than would be possible through a traditional evaluation process conducted at fixed intervals. In these more fluid contexts, it is still important to collect information, reflect on it, evolve the evaluation approach as needed, and make strategic decisions in timeframes that fit with organizational priorities.

Table 3: Propositions for Evaluation in a Complex System

CHARACTERISTICS OF COMPLEX SYSTEMS	PROPOSITIONS FOR EVALUATION
A complex system is always changing, often in unpredictable ways; it is never static	Evaluation efforts should be adaptive, flexible, and iterative
Everything is connected; events in one part of the system affect all other parts	Seek to describe the whole system, including components and connections
Information is the fuel that drives learning and helps the system thrive	Support the learning capacity of the system by strengthening feedback loops and improving access to information
Context matters; it can often make or break an initiative	Pay particular attention to context and be responsive to changes as they occur
Each situation is unique; best principles are more likely	Look for effective principles of practice in action, rather than

¹⁴ Preskill, H., and Gopal, S. (2015) *Evaluating Complexity: Propositions for Improving Practice*, FSG.

to be seen than best practices	assessing adherence to a predetermined set of activities
Different sources of energy and convergence can be observed at different times	Identify points of energy and influence, as well as ways in which momentum and power flow within the system
Relationships between entities are equally if not more important than the entities themselves	Focus on the nature of relationships and interdependencies within the system
Cause and effect is not a linear, predictable, or one-directional process; it is much more iterative	Explain the non-linear and multi-directional relationships between the initiative and its intended and unintended outcomes
Patterns emerge from several semi-independent and diverse agents that are free to act in autonomous ways	Watch for patterns, both one-off and repeating, at different levels of the system

Some funders and intermediaries are already applying these principles to their practice. For example, Lankelly Chase, a philanthropic funder focused on transforming the quality of life of people who face severe and multiple disadvantages, now directs a portion of its grant-making to activities where the primary objective is to learn about the system rather than achieve a specific output. It has also shifted resources away from up-front vetting of grant proposals toward intensive interactions with grantees after grants are made to better enable learning and sense-making from the changes taking place in the system. During its annual review cycle, Lankelly Chase produces a qualitative report, which focuses on learning questions rather than quantitative targets.

This approach to M&E will help organizations monitor and evaluate key features of systems change, but it is no guarantee that organizations will be able to effectively absorb the data and use it to inform strategic decisions. Building a culture of learning internally, and with key partners, will help organizations better respond to shifts in the system that become evident through their M&E activities. Grantmakers for Effective Organizations have described the importance of learning as follows: “Learning is about continual reflection—asking and answering key questions you need to know to make smarter decisions. It is about engaging staff, the board, and grantees in reflective discussion of what works (and what doesn’t) to advance your organization’s mission and goals.”¹⁵

VI. Consider Appropriate Roles and Partners to Support Change

Truly engaging with market system transformation is not easily done from afar because it involves working intensively with a large network of local actors and understanding the nuances of the system. The work of continuously sensing, probing, and influencing described above cannot be done by an entity that does not have a strong understanding of the local context and extensive local relationships, both formal and informal.

Fully implementing the MSI approach also calls for long-term presence and commitment. Systemic change is a long-term process with no pre-determined end point, and many of the tasks required to support the system are long-term in nature.¹⁶ Achieving a rule change, for example, may entail long periods of patient advocacy with little visibility of when the change may be realized. Furthermore, actors with short intervention timeframes may have difficulty building credibility with others in the system; being perceived as a fleeting presence may impede the ability to fully engage, earn the trust, and learn from innovators and other actors.

¹⁵ Grantmakers for Effective Organizations (2005) *Learning for Results*.

¹⁶ Of course, significant changes can occur within a few years, even though the overall arc of transformation is much longer. As such, it is possible to design and run programs focusing on *specific changes* within a conventional 3- to 5-year timeframe, particularly if potentialities are already advanced in their phases of change and there is a strong and ready base of innovative capacities in the system.

Developing Local Presence and Team

Those adopting the MSI approach will also require a certain set of capabilities within their team in order to effectively work across the three spheres—business models and practices, market rules, and norms—in the ways described above. These include:¹⁷

- **Technical knowledge:** The capability to understand the technologies, processes, and practices related to the market, analyze innovations, and provide thought partnership on technical issues to innovators.
- **Socio-political skills and networks:** The capability to understand and navigate the political and social aspects of the system, along with personal and professional networks to leverage in support of change.
- **Systems orientation and thinking:** An appreciation of the nature and characteristics of complex social systems and a capacity to act, learn, and adapt in ways that respond to this reality.

Teams that possess these capabilities are likely to be assembled from a variety of backgrounds including those with experience working with government, business, and civil society. Our own experience, and what we hear from other practitioners, suggests that many teams may have a preponderance of “business people,” and lack individuals who understand the political and social aspects of the system.

Working Through an Anchor Facilitator

Some of us may be able to establish the local and long-term presence required through our own offices or by committing personnel to substantial time on the ground. WISH, for example, is a local Indian funder that can maintain a constant presence on the ground in several Indian states and operate with a deep understanding of the local context. Its commitment to helping scale private innovations within the public health system in India is open-ended, allowing the organization to be seen as a long-term, credible partner by government and by private enterprises.

Parties that cannot establish such a presence should consider partnering with a local organization that can anchor this work. This type of organization can be seen in a number of our case studies, such as FSD Kenya. We refer to such organizations as *anchor facilitators*, and they typically have the following characteristics:

- **Local presence:** They are physically located in the market system, or are can provide significant on-the-ground presence with a deep understanding of the local context.
- **Permanence:** They do not have a pre-determined exit plan and are considered a permanent presence.
- **Commitment to economic inclusion:** They have a strong inherent drive to advance inclusive economic outcomes relevant to us.
- **Flexibility:** They have an organizational form that allows them to be flexible in terms of the precise activities they undertake.
- **Agility:** They can adapt to changing conditions in a timely manner, without needing to continually secure external approval from funders or other stakeholders.

¹⁷ Adapted from Faustino, J., and Booth, D. (2014) *Development Entrepreneurship: How Donors and Leaders Can Foster Institutional Change*, The Asia Foundation and the Overseas Development Institute.

- **Cross-system capability:** They can work technically and politically, and navigate effectively across private, public, and civil society sectors (or partner with others in order to do so).

In some cases, an anchor facilitator might already exist and be engaging (or be ready to engage) with the market system. The work of The Asia Foundation (TAF) on excise tax reform on tobacco and alcohol in the Philippines shows how such an approach could be implemented in practice.¹⁸ In this case, TAF partnered with a well-established local organization, Action for Economic Reform (AER). Founded by progressive scholars and activists, AER works on several policy reform issues including tax justice, clean fuel for the poor, and access to information. AER had previously worked on the issue of excise tax reform so was both interested and well placed to pursue the areas of reform that were of interest to TAF.

The need for flexibility and autonomy in such relationships precludes traditional contracting approaches; instead, the relational contracting approach described above is more appropriate. The anchor facilitator must be trusted to work independently toward a shared objective without rigidly defined plans or targets. For example, neither TAF nor USAID (the ultimate funder) monitored outputs from their support to AER against a pre-determined schedule. Instead, the Asia Foundation maintained extremely close relationships with both AER and USAID, which allowed all parties to build a common and nuanced understanding of the changing context, progress, and needs.

In cases where a ready anchor facilitator does not exist, a new organization could be established through which funders and intermediaries could channel support to the market system. One example of this is Smart Power India (SPI), established in Delhi by the Rockefeller Foundation to facilitate rural energy access markets in India. The Rockefeller Foundation recognized the need for a local, long-term presence to effectively facilitate the market beyond what its offices in New York and Bangkok were able to provide. SPI is staffed almost exclusively by Indian nationals who have deep knowledge and networks connected to the relevant market systems it engages.

Another example is FSD Kenya, a market facilitator initially established by the UK's Department for International Development (DFID), but now supported by a range of funders including the Swedish International Development Agency (SIDA) and the Bill and Melinda Gates Foundation. As a result of a project to improve the capacity of the financial sector in Kenya, DFID recognized the need for an actor that could work flexibly and responsively over a longer time horizon, and so established FSD Kenya as a locally registered trust. It has a hybrid governance structure with fiduciary responsibilities met by independent professional trustees and strategic and technical guidance provided by a separate Program Investment Committee (PIC), comprising representatives from funders and other independent appointees. Notably, the PIC is not involved in programmatic decision-making, providing more space and placing more responsibility on the executive team to develop a program of activity.¹⁹

¹⁸ Booth, D. (2014) *Aiding Institutional Reform in Developing Countries*, Overseas Development Institute..

¹⁹ Gibson, A. (2016) *FSD Kenya: Ten Years of a Market Systems Approach in the Kenyan Finance Market*, FSD Kenya..

Conclusion

We began this report by referring to the global crisis of economic exclusion and inequity that besets the world today. As we end this report, we hope that we have not only shown how positive progress toward inclusion *is* possible, but how it might be made *more* possible.

It is clear that market system innovations are central to these processes of change. The MSI approach can help harness these multiple innovations toward greater inclusion.

But there is another way in which the word “innovation” captures the essence of this work. The English word “innovate” comes from the Latin verb “innovare,” which means to renew, restore, or change. One way of seeing all the case studies described in this report is as stories of how markets can be continually renewed in inclusive ways. In this sense, MSI is not only the work of supporting many discrete innovations within the system, but also of facilitating the innovation of the market system itself.

Doing this work well requires us to embrace some important tensions. It calls for lofty ambitions in envisioning the world we want to see as well as humility in recognizing that we are joining market systems at a point on their long journeys. We must formulate defined goals and robust strategies, but also be truly engaged in learning from the system and responsive to what we find.

This is not easy work, and much remains to be learned. We see the MSI approach described here as a “version 1.0”—we invite others to join us on the journey so we can apply our collective energy and wisdom to this important work.

Recommended Resources

This work stands on the shoulders of giants drawn from many fields, from systems thinking to political governance. Below, we list a selection of their works as recommended reading for those keen to develop a deeper understanding in this area.

Cunningham, S., and Jenal, M. (2016) *Rethinking Systemic Change: Economic Evolution and Institutions*, The BEAM Exchange.

Faustino, J., and Booth, D. (2014) *Development Entrepreneurship: How Donors and Leaders Can Foster Institutional Change*, The Asia Foundation and the Overseas Development Institute.

Green, D. (2016) *How Change Happens*, Oxfam.

McMillan, J. (2003) *Reinventing the Bazaar*, W. W. Norton & Company.

Mulgan, G. (2015) *The Locust and the Bee: Predators and Creators in Capitalism's Future*, Princeton University Press.

Scharmer, C.O. (2009) *Theory U: Leading from the Future as It Emerges*, Berrett-Koehler.

The Springfield Centre (2015) *The Operational Guide for the Making Markets Work for the Poor (M4P) Approach*, 2nd ed., funded by SDC & DFID.

Resources from FSG and the Rockefeller Foundation

Kania, J., Kramer, M., and Russell, P. (2014) *Strategic Philanthropy for a Complex World*, Stanford Social Innovation Review.

Kramer, M. (2017) *Systems Change in a Polarized World*, Stanford Social Innovation Review.

Preskill, H., and Gopal, S. (2015) *Evaluating Complexity: Propositions for Improving Practice*, FSG.

The Rockefeller Foundation and Dalberg Design Impact Group, *Innovation Guide for Funders* www.innovationguide.org

Acknowledgements

The published version of this report will contain full acknowledgements of all those who provided input, feedback, and other significant assistance.