

Technical Report on Inclusive Business

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**People's Republic of China: Shanxi Inclusive
Agricultural Value Chain Development Project**

Inclusive Business

in the Shanxi Inclusive Agricultural Value Chain Development Project

Summary of the Consultants' Team Report¹



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1. INTRODUCTION AND RATIONALE FOR IB:

1. **The Shanxi Inclusive Agricultural Value Chain Development Project.** In 2016, the government of the People's Republic of China (PRC, the Government) requested the Asian Development Bank (ADB) to prepare a USD100 million loan project (the Project) to support the work of the provincial poverty alleviation office (P-LGOP) in creating new income opportunities through agribusiness investments. The Project would pilot test innovative poverty reduction and rural income generation through commercially viable, private-sector business approaches that create new decent jobs in scale, increase income for farmers by producing higher-value products, and support the government's rural development strategies (such as developing priority products by county).

2. **The project works closely with Shanxi agribusiness highlighting “featured agriculture products”.** Shanxi lacks large-scale and profitable agriculture companies. If the additional poverty alleviation impacts come with the costs of the company's financial return, then such poverty alleviation targets will impose additional burden on agribusiness in Shanxi. Therefore, a more sustainable way to engage private-sector companies in poverty alleviation entails innovative solutions that create financial returns for the companies and at the same time increase income for the local poor and low-income community. Meanwhile, in order to promote the growth of agribusiness, both ADB and the government have focused on the “featured agriculture products” that Shanxi has unique resources in, such as products that are uniquely suitable to the planting conditions in Shanxi. Focusing on the comparative strengths of Shanxi agriculture should more efficiently promote the growth of agricultural companies that can both grow their own businesses and alleviate local poverty at the same time.

3. **The Project design included two major innovations, namely**

- (i) using a value chain approach to diversify and upgrade business models for creating stronger industrial development in rural Shanxi; and
- (ii) promoting Inclusive Business (IB) solutions to address poverty reduction and new income generation for the bottom of the income pyramid (BoP, the bottom 40%-60%).

The Project is scheduled for implementation between January 2018 and December 2022. This paper outlines the features of the innovative Inclusive Business dimensions under the Project.

4. **The imperative for new pathways to poverty alleviation:** While the PRC has made impressive poverty reduction achievements since the 1990s, there are four major challenges for the Government to tackle. New pathways are needed to achieve its target of 0-poverty by 2020 and sustain the momentum afterward:

- (i) While lots of public resources have been invested in poverty reduction and “the poor” and the Government continuously upgrade its poverty line to international standards, there is lack of focus on the low-income and vulnerable rural population.
- (ii) Past industrial development and dragonhead approaches on poverty alleviation had limited systemic impact on BoP besides some trickle-down benefits. The past approaches focused more on business performance rather than the needs of low-income.
- (iii) The poverty alleviation efforts were mostly driven by political tasks or the entrepreneurs' own emotional ties to the local communities. Such intentions made it challenging to scale or to sustain the poverty alleviation impacts.

- (iv) The government is currently in the process of formulating its new inclusive growth strategy beyond 2020. In this context, it is interested to engage the private sector to have systemic impact on rural BoP while at the same time not compromising or even strengthening its bottom line financial returns – this is especially relevant in Shangxi's case as most agribusinesses are weak in scale or profitability

2. CHALLENGES FOR ACHIEVING RURAL GROWTH IN SHANXI, AND FOR MAKING IT MORE INCLUSIVE

5. **Past poverty alleviation efforts focus on the poor:** Since 1979, the PRC has been known as one of the most successful countries in poverty reduction in general, and rural poverty reduction specifically. The rural poor population came down from 760 million in 1981 (96% of rural and 88% of total population) to 40 million in 2016 (4% of rural and 2% of total population).² This was mainly due to highly committed, sufficiently budgeted, effective government sponsored poverty reduction programs implemented over the last 30 years. The tremendous economic growth, especially manufacturing, massive urban growth also contributed to such achievement. In its ambitious target to end extreme poverty by 2020, the government, in 2015, set up a household level database for the remaining poor household recording the household-specific causes of poverty, the supporting measures taken, and resulted improvement on annual basis. It also breaks down the alleviation target to local government officials at personal level, which created a new dynamic for poverty reduction at county and prefecture level.

6. **Rural poverty in Shanxi province** is much higher (about 9%³ of rural population) than the national average (about 4%). In the Project region (17 counties in 6 municipalities of rural Shanxi) the poverty incidence is even higher at average 14% of rural registered population⁴. Beyond those extremely poor population, the share of the vulnerable and low-income people is high in the project region at about 40-60% and in some areas where IB projects are implemented even up to 85%. Appendix 1 provides a more in-depth discussion on poverty reduction in the PRC.

7. **Structural transformation in Shanxi:** People in Shanxi province, and especially in its rural areas, were traditionally engaged in coal mining and low value rural agricultural produce. In many regions, remaining farmers are mostly elderly people and women. With the massive closing of coal mines, people in rural areas are increasingly unemployed. Meanwhile, the slow-down of economic growth and less income opportunities in the cities push younger people, especially men to reconsider coming back to the rural areas. However, only few agribusiness companies are making the transition to higher-value products that can offer new and better paid income opportunities for the rural population.

8. **Agribusiness for rural poverty reduction:** In rural areas of the PRC, the poor are mostly engaged as suppliers in the value chains of agribusiness companies. Solutions to increase their income in agribusiness include more production, higher labor productivity, higher prices for their produce, new diversified products, and better access to distribution channels. Good income opportunities through agribusiness supply chains will compensate for the loss of other income possibilities from the closure of coal mines in rural areas and encourage the return of migrant workers to the rural areas.

² Figures are based on national poverty lines. The poverty line of PRC is meanwhile relatively consistent with the international poverty line.

³ Figures are based on data from the Shanxi statistical office and Poverty Alleviation Office.

⁴ Figures are based on data from the Shanxi statistics year book.

9. **Limitation of current industrial development and dragonhead approach for poverty alleviation:** Since the mid-1980s, the Chinese government promotes the so called “dragonhead” approach as a key feature of its agricultural rural development programs. Initially state-owned and later privatized companies were built up as key agribusiness industries in counties and got special government support through additional access to financing, tax reliefs and reduced administrative costs, etc. Today, Shanxi has more than 415 large-scale agribusiness companies. 83 of them are classified as national and 32 provincial dragonhead companies. However, the traditional industrial development and dragonhead approach was not much specifically targeting of the BoP (rather the better-off farmers), nor in enhancing coverage or income depth in rural areas. While the total size of the impoverished population was significant, poor people inevitably benefitted somewhat from traditional dragonhead approaches as a spill-over effect. However, as the number of people impacted by poverty decreased over time, the need to better target the low-income people becomes strategically important. Such emphasis was highlighted in the government’s slogan of “precise poverty reduction”. IBs are defined as companies with business lines that specifically target solutions to the relevant problems of the poor and low-income people. Hence, in the rural economy, IB solutions are much more relevant for social well-being of the poor and low-income farmers than traditional companies or dragonhead businesses.

10. **Relevance for inclusive growth:** The IB dimension of the Project is highly relevant for stimulating new economic growth in rural areas and ensuring the benefits of new investments and economic growth can be shared with poor and low-income people. Such approach has three major differences to a traditional poverty approach: 1) it targets not only the extreme poor people (those under the Chinese poverty line of about RMB 2,855 per capita per year disposable income in 2015, i.e. households with approximately RMB 8,565 disposable income per year), but also the low-income people (those with family income up to RMB 26,070)⁵; 2) it aims at creating commercially viable win-win options for the company and the poor and low-income people. As a result, increasing the well-being of the poor and low-income population can create additional commercial opportunities for the companies, and therefore can better engage private sector’s willingness to change. 3) IB organically integrates beneficiaries into business’ main value chain, therefore making the impact more sustainable.

11. **IB often builds on the value chain approach:** promoting the IB approach and strengthening agribusiness value chains (VC) are the two key innovation features of this Project. IB and VC build on each other to achieve balanced impact on both business and the BoPs. While the ultimate focus of the IB approach is on poverty reduction and better living conditions for the rural low-income people, the purpose of value chain is more focusing on the company. While VC analysis can stand on its own, the IB approach needs the value chain approach to broaden reach and depth among low-income people while at the same time enhance further profitability along value chains. This is mainly because diversification into higher value products and more deeply integrated markets are the key determinants to increase income for the poor. To achieve higher

⁵ The threshold for rural low-income households is based on the international agreements on low-income households under the IB discussion which is the base of the income pyramid or the bottom 40%-60% income groups. We use the per capita average annual disposable income of middle income group of rural households in Shanxi (CNY8689.81 in 2015) as the proxy for the median of annual rural disposable income. . Therefore, the annual disposable income of CNY26,069 per household (the average size of a household is 3) was applied as the low-income threshold in this IB analysis. This is slightly lower than CNY 30,000, a provincial rural average disposal income for the threshold for rural low-income households used in Summary Poverty Reduction and Social Strategy (Appendix 12 of Report and Recommendation of the President to the Board of Directors “Proposed Loan and Technical Assistance Grant for the People’s Republic of China: Shanxi Inclusive Agricultural Value Chain Development Project). Setting this new threshold is to make IB targets more rigorous and strengthen project impact on low income people. In future implementation and monitoring, the value of this proxy derived from the statistics year book will be used to set the low-income threshold or to identify the bottom 50% income group of the rural population in Shanxi.

profitability and less risky investments, the company needs to understand and better integrate the market of the poor in its business model. IB companies in agriculture therefore often use highly innovative value chain approaches, while focusing on finding solutions to the low-income farmers' problems. Therefore, the Shanxi Project aims at achieving synergies between the VC approach and the IB approach.⁶

3. INCLUSIVE BUSINESS - A COMMERCIALY VIABLE APPROACH FOR RURAL POVERTY REDUCTION

12. **Inclusive Business** are commonly defined as for-profit companies that use their core businesses to create commercially viable and scalable solutions to tackle the relevant problems of the poor and low-income people. Inclusive Business models are mostly promoted by medium-sized enterprises. However, some IB initiatives are also provided by for-profit social enterprises, and by corporate social responsibility activities of larger enterprises. Many Inclusive Business solutions for the rural poor are related to agribusinesses.⁷

13. **What qualifies IB in agribusiness?** Typically, Inclusive Business models in agribusiness are characterized by four traits:

- (i) IB companies create additional employment and income opportunities on a large scale through business expansion;
- (ii) IB companies pay better than their peers, because IB companies tend to use higher purchasing prices to secure higher-quality raw materials to produce higher-value-added end products;⁸
- (iii) IB companies improve the social well-being for the poor and low-income population, including reduced risks and better living conditions; and
- (iv) IB companies are defined and measured by a quantitative IB composite metrics.

14. **Inclusive Business creates a win-win solution for both business and low-income farmers:**

- (i) For business, IB uses the market and potential of the poor and low-income people (as suppliers, distributors, and consumer) as a new source of (a) revenue generation, (b) business risk reduction and for (c) strengthening the company's competitive advantage and hence its final profitability. IB models create specific values for business such as stronger consumer brand value, more diversified business portfolio, better value proposition along supply chain, and more loyal and productive labor. IB's success has been proven and acknowledged widely in international markets.
- (ii) For the poor and low-income farmers, IB models help them to be organically integrated into the business's value chain. In addition to enjoying more income opportunities through expansion of business, farmers can also increase income through new

⁶ A good example is a poultry company, which understand that setting up a social enterprise fund to encourage the youth establishing new companies in its immediate value chain area (such as transportation or marketing through IT means) can help the pig company reducing risks and broadening sales.

⁷ For more information on Inclusive Business, please check out the IB Asia website at <http://www.inclusivebusinesshub.org/micro-site/inclusive-business-in-asia/>, and the IFC website on Inclusive Business at http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/Inclusive+Business.

⁸ Engaging many poor while paying little and hence keeping them poor does not qualify as an IB.

innovative (e.g. intercropping) or higher value products (e.g. organic products), and in some cases through becoming shareholders of the IB company. In a nutshell, farmers' benefit will be naturally secured from business success; therefore, the impact on poverty alleviation will be more fundamental and sustainable.

- (iii) Different from enterprises' traditional CSR approaches, or a passive acceptance of top-down political task from government, the win-win nature of IB mobilizes enterprises to fully deploy their business resources and innovation to upgrade their business while benefiting the poor. By engaging the poor and low-income in the core businesses, the IB companies can create larger scale and more financially sustainable poverty alleviation solutions.
- (iv) IB also expects to collect the best-quality harvest from farmers to produce higher-end products that are sold at premium prices to the end clients. In order to secure such the best-quality harvest, IB companies usually pay well-above-market purchasing prices and hence generate additional income for farmers. Moreover, the IB companies produced higher-value-added products that require fairly constant supply of raw material from farmers. The stable demand alleviates some of the farmers' of risks of not selling their harvest. Furthermore, IB companies also hire farmers as employees to manufacture their end-products, creating another source of stable income for farmers. In the context of Shanxi, this will be crucial, as farmers have limited sources of additional income as a result of unbalanced economic structure and relatively small-scale dragonhead companies. For the interest of the public and the government, moving farmers up the value chain and creating additional sources of income further make poverty reduction more sustainable.

15. **Innovation is a key requisite for any IB model.** Enterprises are profit and growth-driven by nature. However, in many poor areas of Shanxi, the scale of featured products and business is small, despite the companies and farmers' strong willingness to echo the "one village one product" policy. The purposes of promoting innovation are as following:

- (i) create high value-added products that are sold at premium prices;
- (ii) "out-of-box" thinking on their business model to include more poor and low-income people, and pay them better;
- (iii) create commercial solutions that are environmentally sustainable and financially viable. Such IB innovations include moving to a more premium-end market with higher price points, diversifying the business from single-product to a value chain business, reposition the company's as "social value" brand for a better consumer recognition, etc.

16. **IB models need be created and cannot simply be found.** While IB models emphasize the win-win synergies for companies and the poor, the private sector often does not make the shift to become IB. This is sometimes due to lack of understanding, innovation, or even willingness and encouragement of the management. For the entrepreneurs who intend to improve the well-being of the local community, such intention is mostly driven by personal emotional ties to their hometown or by top-down tasks, instead of commercial interests. However, focused advisory services can change companies substantially. Of the 10 IB models under this Project, only one existed before the consultant team started the IB discussion with the companies. All other IB models of today are results of "IB incubation" during Project preparation. It is important to clarify that those changes in business models were voluntary and based on an understanding of the business and social rationale. Companies were made aware of the potential to achieve both additional financial returns and poverty alleviation impacts by incorporating the poor and the low-income into their core businesses. Moreover, as a part of the Shanxi projects, IB companies will receive additional benefits, which encourages the project companies to adopt the IB models. For

example, one of the incentives is that IB companies will be awarded a government certificate, which potentially can boost brand value of the IB companies. There are also additional financial incentives for IB companies, such as priority access to the ADB revolving loan, which are illustrated in the following sections.

17. **Changing companies to adopt IB models.** The IB accreditation criteria were used to discuss with all companies to modify their business models to achieve greater social impacts. The end of this process was the drafting of an IB agreement in which the companies specified the changes they plan to make to achieve such social impacts. These changes were detailed in a time-bound action plan, and there are additional rewards if the action plan results are achieved. Typical changes in revising the business plans comprise not only social innovations but also business and financial innovations, and sometimes environmental measures beyond safeguards. Typical social innovations are:

- (i) coverage increase through expansion, such as engaging new farmers and more targeted sourcing of materials from the poor and low-income farmers;
- (ii) income increase through diversification or upgrading product lines with higher value products from more farmers especially the poor or low-income farmers;
- (iii) lower income risks including longer-term purchase contract, company sharing parts of its net profit with high-performing low-income farmers.

18. **A public good:** The current understanding among both the government and businesses is that the public sector is mostly responsible for poverty reduction efforts, rather than the private sector. Therefore, in order for more private-sector companies to actively transform their business models into IB models and consequently contribute to poverty reduction, the government needs to have more encouragements and incentives towards such IB models. The specific incentives will be illustrated in the subsequent sections.

4. THE IB FEATURES IN THE SHANXI PROJECT

19. **The Inclusive Business (IB) dimensions of the Project.** The purpose of the IB components are to modify project companies' business models to create more well-paying jobs for the poor and low-income people. To achieve this, the Project will implement the following 7 components:

- (i) IB accreditation and company selection
- (ii) IB financial incentives for companies with IB models
- (iii) IB business development
- (iv) IB awards to encourage more companies to join the social business route
- (v) IB dissemination and pilot upscaling; and
- (vi) IB impact assessment at company and project level, and feedback collected from farmers involved in the company's supply chain

The government agreed to finance those components through the loan (USD 1.25 million for consulting services to do IB business development, IB dissemination, IB impact assessment, and IB awards) and through additional resources from its own budget (for financial incentives and for financing workshops, training, and event costs of the IB awards). These costs will at the end be financed by the companies through their interest rates and repayment conditions, which are slightly higher than those ADB provides for poverty reduction objectives in the PRC.

for business development, financial risk reduction, technical innovations that directly help the poor (e.g. business diversification to new income sources of the poor and low-income people), and sales promotion.

22. **Financial incentives for IB:** The government agreed to provide specific financial support to companies with IB models. The additional financial incentives for IB companies are needed as means to encourage more companies to become IB companies. IB companies have priority over non-IB companies to receive the revolving loans after the first round of loan completes on condition that the IB companies can achieve the pre-aligned IB targets defined in the respective IB action plans. In addition to the priority access to the revolving loans, companies are also eligible for longer grace period and repayment period. The specific execution is subjected to local PMO and financial bureau's discretion and should be considered on case-by-case basis.

Figure 2: An Example of Triggers for Financial Incentives

Timing and conditions for decisions on financial incentives							
	year 0	year 1	year 2	year 3	year 5	year 6	year 7
	2017	2018	2019	2020	2021	2022	2023
IB agreement	X						
additional 1 year more grace	X						
additional 1-2 year repayment time			X				
interest rate subsidy repayment					X		
progress reports		X	X	X	X	X	
impact assessments			X		X		X

23. **IB award system:** IB companies are successful, because they innovate to solve relevant problems of the poor and low-income people, mostly through engaging farmers to produce higher-value products. IB companies are often innovative in empowering women and youth and caring for the elderly through economic development. To expand knowledge on IB and encourage other companies in Shanxi to also set up IB models, an IB award program will be established and held every two years. The IB award program will be implemented by the Project Administration Office (PAO) of the provincial Poverty Alleviation and Development Bureau (PADO), in cooperation with PADO, the provincial agriculture bureau, the provincial department of commerce, and the provincial chapter of the All-China Federation of Commerce and Industry, especially its "guangcai"¹⁰ group. The government agents will give all the companies that receive the IB awards respective certificates that the companies can use to strengthen their brands and attract further business opportunities. The award will also be documented through innovative modern media. Eventually selected business and government representatives from other regions in the PRC interested in investing in or learning from Shanxi can also participate.

24. **Dissemination of knowledge and building a sector:** The IB dimensions in the Shanxi Project are particularly innovative, and have three major positive development impact:

- (i) increased job and income opportunities for the poor and low-income people;

¹⁰ Guangcai (Glorious Cause) is an initiative of about 20,000 business people (mostly larger and medium sized private and state owned companies) in the PRC which started in the late 1990s to support the government's go West strategy. *Guangcai* entrepreneurs sponsor corporate social responsibility, social enterprise, and inclusive business investments in poor areas of the PRC. The national Leading Group on Poverty is currently exploring a program with the *guangcai* entrepreneurs and the Ministry of Commerce to further support the "precise poverty alleviation" strategy of the government through private sector solutions. The Shanxi IB agribusiness project was considered as a pilot for this purpose.

- (ii) the IB incubation process strengthened the company's financial and business management;
- (iii) create more diversified economies along the various components of the supply chain;

Reporting the approaches and impact to other companies, other provinces and even other countries can help the Chinese government advocate for the innovative poverty alleviation efforts. Hence, the Project includes activities for knowledge sharing and strategic exchange. At company level, the Project will use innovative media such as films, radio and TV reportages, "WeChat" information sharing, and internet platforms to share information on inclusive business models with other companies and with farmers.

25. Piloting new approach for poverty reduction in PRC: The national LGOP is cooperating with the Ministry of Commerce and the "guancai" group under the All-China Federation of Chambers of Industries (ACCCI) in testing new approaches for private sector involvement in precise poverty reduction. "Guangcai" (Glorious Cause) is a group of about 10,000 business leaders under the ACCCI, formed in the end 1990s to support the government's "Go West" strategy. While many "guancai" investments are traditional CSR activities or dragon-head investments, some can be classified as inclusive businesses with large-scale and tangible social impact. However, such guancai companies with IB models are still very limited. Most of the guancai companies still position improving well-being for the low-income as creating additional corporate social responsibility costs. Different from the guancai approach, the Shanxi project is exploring a new poverty alleviation solution that combines both the business interests and social impacts. Such a new approach is seen as a pilot for the national government's new poverty reduction and inclusive growth strategy.

26. Special IB impact monitoring and reporting. The Project has three ways to monitor and report on the results in the field (Appendix 5 provides more information on the IB monitoring approach and implementation):

- (i) Companies will set up IB impact monitoring systems and report yearly. They will use innovative modern media such as "WeChat" to inform their suppliers and customers about new developments and prices.
- (ii) The PMO will prepare at mid-term and the end a comprehensive development effectiveness report on the IB impacts.
- (iii) Conscious efforts will be made to include in both reports the feedback of the poor and the low-income, and a separate report will validate the findings through the perspectives of the poor and the low-income.

27. 10:1 - The innovative features of the IB component under the Project: The IB approach under the Project is an innovative way to encourage triple win between (a) better business for private sector, (b) more successful approaches for government to reduce poverty; and (c) better income and socio-economic development for the low-income rural people. The IB component of the Project will support 10 innovative mechanisms. It will:

- (i) create higher value-added product lines and hence new revenue sources for both the companies and the farmers;
- (ii) diversify the economies of the poor and reduce risks for agribusiness company by stabilizing farmers' income and also securing raw material supply for companies.
- (iii) through the IB agreements and reporting mechanism, encourage more transparency in how and when the changes in the business model will be effected
- (iv) generate new employment through interlinking IB and VC objectives and advisory services;

- (v) make CSR more strategic and related to the core business, such as retention of young talents
- (vi) enhance gender equality among the poor and in the management of the firm;
- (vii) bring innovations for the youth and the elderly (new job opportunities);
- (viii) promote ecological innovations along value chain to create win-wins for business, people and the environment
- (ix) not only support a few individual companies, but build a whole sector through leadership and example giving
- (x) pilot a new strategy for poverty reduction in the PRC.¹¹

In sum, the IB dimensions under the Project are designed not only for replication in Shanxi, but also in other provinces of PRC and at the national level. Its approach already finds interest in the international discussion, and the initial results will give more recognition and appreciation for the PRC's development contribution to the world.

5. THE SOCIAL IMPACT OF THE IB INVESTMENTS: EXPECTED OUTCOMES AND IMPACTS

28. **Social impact goes much beyond counting the number of beneficiaries:** Most development projects count the number of “beneficiaries” with limited efforts to distinguish between the forms of benefits and the distribution of benefits to different socio-economic groups. To present more holistic social impacts, this paper summarizes a more comprehensive social impact analysis including the job and income benefits by granular beneficiary groups (by income group, gender, and age) in the value chain of the companies. In general, we find that horticulture related value chain companies have higher social impact than husbandry related companies. Companies with business models of wider and higher value chains create new jobs in scale and higher income. Moreover, the intention of the project companies’ management teams significantly determines whether the businesses will change their business models to increase the company’s profitability and social impacts.¹²

29. **Better reach means new jobs for better targeted low-income people:** The 19 companies under the Project benefit about 73,871 households (or about 221,613 people). With expanded operations under the project, the project companies will employ 1,859 people fulltime; engage 37,220 farming households as immediate suppliers; and positively impact 35,850 households in the wider value chain as buyers and supplier. Inclusive business companies create more and better jobs than the non-IBs:

- (i) 82% of the jobs in the immediate value chain come from IB companies and only 18% from non-IB companies.
- (ii) IB companies are also much better targeting the poor and low-income people: While in IB companies 89% of the new jobs generated go to the poor and low-income people (29% for the extreme poor and 60% for the low-income households), in non-IB companies it is 59% (and 11% and 48% respectively). Of the total jobs for the low

¹¹ The International Poverty Reduction Center in China (IPRCC), in cooperation with LGOP and *guangcai* is currently experimenting on the 10,000 companies supporting 10,000 villages approach. The program wishes to embrace IB concepts to have a more strategic approach on economic development for poverty reduction through the private sector.

¹² Note that many of those IB changes are not reflected in the feasibility study prepared by the Chinese design institute. They are often financed by the company’s own money and were so not reflected. In essence, the feasibility study substantially underestimates the social impact.

income and poor people 83% are coming from the IB companies and only 17% from the non-IB companies.

- (iii) Finally, IB companies are also much more labor intensive with their investment than non-IB companies: While investment cost (ADB loan only) per beneficiary is about RMB 22,183 for IB companies, it is RMB 165,409 for non-IB companies.
- (iv) IB companies also differ from non-IB companies by (a) paying higher prices (and often wages) than non-IB companies, (b) paying better than the market rate (competitors), (c) creating substantial income increase that bring people out of poverty and low-income status on a sustainable basis, and (d) having better risk reduction mechanism for the poor through promoting diversified income opportunities.

30. **Social depth** in agribusiness means that the poor and low-income can increase their income over time and that the IB companies pay the poor and the low-income better than their competitors do. A major emphasis during the IB incubation was on how the company could create not only more jobs, but also better-paid jobs. Better jobs imply that the IB companies pay 10%-40% higher for farmers' harvest than the competitors, engage the poor in new value chains, achieve higher value products and share the profit with the poor, create new income opportunities through multiple uses of inputs (e.g. intercropping) or through more productive use of idle time of farmers (especially new women employment during off seasons). As a result, the poor and low-income people under IB models can earn more than what they have earned before. Moreover, such households also earn more than other farmers working for non-IB companies.

31. **Systemic change is important for the relevance of the business model:** IB models were also rated the systemic impact they can create in poverty alleviation. This also included an analysis of the job opportunities in the value chain of the company, and how it contributes to the government's one county one product area strategy. Some companies have very high relevance for poverty reduction and inclusive development, because they are one of the few significant buyers for farmers' harvest and hence the main sources of income for the local farmers in the respective region. Other companies may not be the only buyer of the product but have the most innovative business model and hence offer the poor the best income source in the future

32. **Additional social innovations and CSR:** The Project intended to make project companies' existing CSR activities more strategic by linking the activities to their core businesses, and instilling more transparency. For example, some companies agreed to substantially increase their CSR allocation close to the international standard of 2-3% of the net profit margin, and establish a transparent reporting system.

33. **Increase well-being for women, youth, and the elderly:** In all discussions with the companies (both IB and non-IB), efforts were made to enhance the role of women, youth and the elderly in the Project. However, mostly only the IB companies were interested in linking such issues with their active business strategy. As a result, some IB companies established new business lines for those target groups; others included more women, youth and the elderly into the company's management and decision-making process.

34. **Other innovations to enhance social impact:** In conclusion, the IB companies promote a range of innovative approaches to improve well-being for the poor and low-income people (see appendix 9). Figure 3 below summarizes the social impact rating for companies with IB models. Compared to traditional companies under the Project, IB companies are more relevant for poverty reduction, have much better reach, higher depth, much better systemic impact on poverty, and stronger social innovations and CSR. IB companies also have high ratings for targeting poor and low-income people, and empowering women. Some IB companies also emphasize the youth and

the elderly although overall impacts are still limited. For further reference see the tables in Appendix 9.¹³

Figure 3: Social impact rating of the companies with IB models

company		IB dimensions of the investments										update: 27 Sep 2017											
no	name	product	location prefecture /	the county	rele- vance for poverty reduc- tion	reach	depth	systemi- c change	social innovat- ions, CSR	targeting				Inclusive Business		IB+VC score	IB score	social impac- t score	financ- ial and busi- ness innov- ation	industry leading (VC + scale + growth potentia- l as percent of total score)			
					high (5,6), medium (3,4), low (1,2)					high (5,6), medium (3,4), low (1,2)													
1	Qinzhouhuang	millet	Changzhi	Qinxian	1	6	4	5	5	5	2	5	2	1		6.21	4.63	2.61	1.93	2.84			
2	Bei Ye	mushroom	Datong	Guangling	4	4	4	3	3	4	3	2	2	1		5.21	4.63	2.06	1.61	2.56			
3	Phoenix	wine	Datong	Datong	4	2	3	2	3					1		4.48	3.02	1.55	1.41	2.50			
4	Juxin Weiye	seeds	Jinzhong	Taigu	4	6	5	3	2	3	3	3	1	1		5.24	3.68	1.98	1.64	2.65			
5	Lvhe	cow	Jinzhong	Heshun	2	1	2	1	1					1		3.34	2.38	0.97	1.35	1.63			
6	Hongchang	chicken	Linfen	Fenxi	3	2	2	1	1					1		4.50	3.00	1.41	1.53	2.70			
7	Guhuan	husbandry	Linfen	Fushuan	2	2	2	1	1					1		3.30	2.44	1.21	1.20	1.49			
8	Lvheng	mushroom	Linfen	Quwo	3	2	2	2	1					1		2.58	1.88	0.65	1.20	1.17			
9	Quierkan	chigu	Linfen	Xiangning	5	5	4	4	3	5	2	2	1	1		5.53	4.07	1.95	2.00	2.53			
10	Zhongde	pigs	Linfen	Yaodu	3	3	4	5	5	4	3	5	1	1		4.60	3.48	1.68	1.65	2.05			
11	Fuzhongyuan	pigs	Lvliang	Liulin	2	3	3	2	2					1		3.61	2.81	1.34	1.38	1.40			
12	Shude	dates	Lvliang	Shilou	6	6	5	5	5	6	4	3	4	1		5.44	4.14	2.15	1.96	2.18			
13	Tianzhirun	dates	Yuncheng	Ruicheng	6	6	5	5	5	5	4	2	2	1		6.21	4.55	2.42	2.07	2.92			
14	Hefeng	grain	Yuncheng	Xinjiang	6	5	4	4	4	6	3	3	2	1		4.59	3.45	1.87	1.53	1.90			
15	Xinjiang Vegetable	veg. Market	Yuncheng	Xinjiang	4	5	4	3	3	4	3	2	2	1		5.49	3.99	2.16	1.78	2.56			
16	Kaisheng	mushroom	Yuncheng	Yanhu	2	1	3	2	3					1		4.18	3.18	1.13	1.96	1.86			
17	Xinke Taifang	veg. trading	Yuncheng	Yanhu	2	5	5	2	1					1		4.32	3.52	1.35	2.13	1.33			
18	Shanlihong	walnuts	Yuncheng	Yuanqu	5	6	4	4	4	6	4	3	2	1		4.87	3.73	1.78	1.88	2.00			
19	Jinglong	eggs	Yuncheng	Jishan	1	1	1	1	1					1		3.25	2.35	0.70	1.63	1.51			
TOTAL														10	9								
benchmark for qualifying as IB average																>3.3	>1.7	>1.5					
all companies														19		4.55	3.41	1.68	1.63	2.05			
IB and potential IB companies														10		5.34	4.04	2.09	1.80	2.39			
non-IB companies														9		3.67	2.72	1.22	1.45	1.64			
maximum score possible																7.80	6.00	2.88	2.88	2.88			

35. **IB companies do not compromise financially.** It is important to emphasize that all those social innovations are not coming with costs of financial performance. In the contrary, IB companies have on average even have higher profitability, higher revenue, and larger share of self-financed investments than non-IB companies. While their social impact score is higher than that of non-IB companies, their financing score is also better than that of non-IB companies. IB companies also have stronger better integrated value chains and stronger business growth strategies.

6. RECOMMENDATION FOR IB IN THE PEOPLE'S REPUBLIC OF CHINA

36. **Structural challenges to more effective poverty reduction:** The Government, under the Leading Group of Poverty (LGOP) and its provincial Poverty Alleviation Offices (PADO), has an active poverty reduction program with a clear financial commitment.¹⁴ At decentralized level, this is integrated with the county and prefecture planning. The government realizes current challenges such as lack of practical means to achieve poverty reduction targets, difficulties to engage in implementers outside of government agents, and challenges to include the low-income population in addition to the poor.¹⁵

¹³ There is no comparison rating with non-IB companies. However discussions with those companies revealed that most of them are not interested in targeting socially excluded people).

¹⁴ The allocations for poverty alleviation in Shanxi province amount to about RMB 330 million per year. They are further supplemented through other line agencies budgets.

¹⁵ An interesting case is a company that targets specifically coal mining families who lost their jobs due to economic transition to engage them in new husbandry related income opportunities.

37. **The Shanxi project (the Project) aims at piloting a localized IB mechanism** to promote private sector solutions to poverty reduction and sustainable development, and upscale the approach for usage in other industries, other provinces and nation-wide. Key activities include:

- (i) Company appraisals using a tailor-made four-dimension scoring tool for subproject selection and potential IB identification;
- (ii) IB incubation, IB action plan formulation, and ex-ante IB social impact assessment;
- (iii) Social impact monitoring and verification;
- (iv) IB incentive programs, such as the IB award program;
- (v) Continued advisory and training support for IB model development;
- (vi) Mainstream the IB approach to alleviate poverty at the provincial government level.

38. **Relevant for other provinces and the national government:** The Shanxi Project with its Inclusive Business focus is seen by other provinces and the national government as a pilot for more private-sector development program for the rural poor and low-income people. Therefore, there will be exchanges of project experience with other provinces that showed interest to replicate the IB model (e.g. Inner Mongolia, Heilongjiang and others). Furthermore, the Shanxi experience is a good case for new approaches of poverty reduction and making growth in rural areas more inclusive at the national level. Leveraging the private sector strengths to contribute to poverty reduction and inclusive growth is increasingly highlighted by the government. Thus, the IB approach tested in Shanxi can be a good pilot for shaping the post-2020 work of the government on inclusive growth.

39. **The IB approach is relevant for the world:** PRC has gained worldwide respect for its highly successful and committed poverty reduction. In 2016, under its G20 leadership, the PRC government also engaged in international discussions to promote Inclusive Business. The Shanxi project is an excellent example of private-public sector partnership to find new ways for more successful poverty reduction and inclusive growth. Other countries are interested in learning from the Shanxi example: the Shanxi project was referred to during the recent G20 Inclusive Business forum in Berlin (May 2017) and will be referred to during the 2017 APEC and ASEAN meetings focusing on Inclusive Business. In a recent discussion with ADB, the governments of PRC, the Republic of Korea, Japan, and Thailand also showed interests in engaging in a Project that could promote their own possible IB investments in Mekong countries. The specific country governments are interested in using the IB approach to thereby create new jobs for the poor in those countries and at the same time improve branding of the respective private-sector companies. The government of PRC can share its Shanxi experience though participating in selected study tours, international conferences, and promoting knowledge exchange through academic papers.