Alleviating Poverty through Value Chain Innovations

For Chinese professionals leading hectic lives in crowded city centers, vacation provides a rare opportunity to slow down and breathe some fresh country air. As urban centers become more populated and polluted, city dwellers have increasingly started to seek out getaways in rural areas where they can live on a family farm, enjoy authentic food, and take part in local activities.

On top of providing rest and relaxation to urban tourists, these homestays can become a much-needed source of income for impoverished rural families, who subsist largely on scant revenue from small-scale farming. Traditional family farms, situated in the midst of abundant natural beauty, could potentially offer a rich opportunity to tap into this emerging tourism trend.

As statistics from the China National Tourism Administration show, road trips to rural areas are on the rise. During the 2012 National Holiday alone, the number of visitors driving to one popular tourism destination, Yunnan Province, increased by 78 percent. These numbers show the growing popularity not only of rural tourism, but also of “self-drive” traveling, the usual way to visit remote areas. Fueled by an increase in car ownership, and a growing preference for extended vacations over sightseeing tours, total demand for road trips reached almost 900 million person trips in 2012.

At the same time that travelers are venturing farther outside the city, they’ve also begun to spend more on their vacations. China’s tourists are among the biggest spenders in the world, paying more than $102 billion for international travel in 2012. Young professionals in particular, who tend to favor vacations in remote locales, spend lavishly on travel, with some having a vacation budget of up to $300 a day. Travelers are increasingly spending their vacation dollars on destinations within China as well, with domestic travel increasing approximately 10 percent annually in recent years.

Yet despite the number of tourists seeking country getaways, China’s farmers have found homestay tourism difficult to develop and sustain. Few have the means to furnish high quality lodgings, nor the experience to successfully market and manage a tourism business. Local governments do not have the expertise or the financial resources to promote small villages as vacation destinations. And financing from investors outside the community comes with its own problems.

In recent years, real estate and hotel developers have turned their attentions to non-urban and resort areas, including established resort areas as well as entirely new destinations such as Fuxian Lake and Tengchong in Yunnan, or the Shenzhou Peninsula on Hainan Island. While these investors may be able to construct hotels and other accommodations that bring in wealthy tourists, this type of development can lead to uncontrolled growth that harms the environment and disrupts local culture. In addition, few of the economic benefits ultimately trickle down to the local community.

Old Town Lijiang, a historic town in Southwest China and a UNESCO World Heritage Site, offers a cautionary tale of unchecked tourism development. The town has become a popular
travel destination, receiving more than 15 million tourists and generating over $3.3 billion in tourism revenues annually. However, commercial success has come at the steep cost of environmental damage and cultural degradation. As Old Town Lijiang’s ancient waterways became contaminated with sewage, and its cobbled streets transformed into a red light district of bawdy nightlife, much of the indigenous Naxi population began to flee the town.

Researchers working with SEED’s value chain research initiative¹ have assessed these challenges and developed a new approach to rural tourism in China that preserves the authenticity of the region. Moreover, it meets the needs of urban travelers—while turning rural farmers into entrepreneurs. By making crucial changes to the rural tourism supply chain, these researchers developed a homestay model that alleviates poverty in rural communities, in an economically, socially, and environmentally sustainable way.

The research team analyzed the traditional tourism supply chain typically used in emerging markets, and reconfigured it to foster greater participation among the local community. While the traditional tourism supply chain, as illustrated below, largely relies upon intermediaries such as hotel operators and travel agents, researchers sought to integrate local products and services more fully into China’s tourism market. They found that the need for innovation was particularly pressing in rural markets, where non-local businesses dominated the tourism industry.

Example of a Traditional Tourism Supply Chain in Emerging Markets

![Diagram of Traditional Tourism Supply Chain]

<table>
<thead>
<tr>
<th>Source of Earnings:</th>
<th>Input Supplier</th>
<th>Hotel Owner</th>
<th>Hotel Operator</th>
<th>Tour Operator</th>
<th>Travel Agent</th>
<th>Online Travel Agent</th>
<th>End-User</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales of goods &amp; services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hotel Revenues</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management Fees</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commissions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commissions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Flow of goods, services and moneys:**
1. Suppliers provide labor, goods and services
2. Hotel owner to provide asset
3. Hotel operator provide management services, including lodging, food services, marketing, distribution
4. Tour operator packages travel products and aggregates demand
5. Travel agents aggregate demand and distribute products to consumers
6. Provision of (access to) travel experiences

¹ The research team comprises Hans Galland, Vivek Garg, and Thomas Yao, three Sloan Fellows (2013) from the Stanford Graduate School of Business; James Shen, Founder and Partner at the People’s Architecture Office in Beijing, China; and Tilky Xu, a Ph.D. candidate in Economics at Stanford University. The project was supervised by Professor Hau Lee, the Thoma Professor of Operations, Information and Technology in the Graduate School of Business and the faculty director of SEED, and Professor Nicholas Hope, the director of the Stanford Center for International Development. The China Social Innovation Foundation and Southwest Jiaotong University in Chengdu provided on the ground research support.
“Relying on outside investors to develop tourism is very common in emerging markets, but causes leakage of economic benefits to outsiders,” explains Hans Galland, a member of the research team with ten years experience as a tourism investment professional in China. “Our model, in contrast, is community-centric, not only growing the economic pie, but also enlarging the community's slice of it,” adds Vivek Garg, who, before coming to Stanford, focused on entrepreneurial incubation in his native India.

In a recently completed pilot study, these researchers propose a homestay model that encourages community participation by building the entrepreneurial capacity of local farmers. By providing farmers with a homestay product financed by micro-loans, this model emphasizes the private sector, redistributes ownership to the local community, and has the potential to significantly raise the household income of rural families.

The study was conducted in PuXing, a mountain village in southwest China dotted with tea shrubs and fruit orchards. Despite boasting the natural and cultural attractions city dwellers desire, PuXing residents currently generate just 10 percent of their income through tourism. Situated only twenty minutes away from the Mount Emei and Leshan Giant Buddha Scenic Area, which drew nearly 300 million visitors in 2012, PuXing has the potential for tourism development, and could become an attractive destination for tourists who want to escape the crowds, extend their vacation, and enjoy PuXing’s unsullied way of life.

A homestay in PuXing offers urbanites the chance to immerse themselves in the day-to-day life of a small agricultural community. Tourists can join their host family in farm chores such as picking tealeaves, and learn how to prepare traditional cuisine. They can also tap into the rich spiritual heritage of the area by partaking in Buddhist traditions. Many may choose to time their vacations to coincide with the annual Peach Blossom Festival, which draws as many as 200,000 visitors to the town every spring.

Given the natural, cultural, and culinary appeal of PuXing, perhaps it isn’t surprising that a few local families have tried to host tourists in their homes. However, researchers found that supply chain challenges got in the way. It turns out that farmers’ own homes weren’t up to the standards of urban visitors, but the high costs of refurbishment didn’t leave much of an option. Homes in this region are often poorly maintained. Typically made from clay, they are also not energy efficient, and therefore don’t represent a sustainable lodging option for tourists.

Even if their houses were in better condition, farmers found it difficult to effectively market their homes to attract a constant stream of visitors. Researchers also discovered that many families resisted the idea of turning their homes over to strangers, wary of the intrusion that tourists would bring.

To overcome these issues, researchers introduced a new product into the value chain that enables local farmers to become owner/operators in the tourism market. Their solution takes the form of a 24-square-meter modular pod, placed on the farm premises, which farmers could purchase through a loan.
For tourists, pods offer an ideal combination of modern conveniences and small-town hospitality; tourists get a taste of the farming lifestyle, without causing the family any disruption or displacement. Tourists also get to experience PuXing from the best possible vantage point, because pods can be placed in the most appealing and scenic locations on the farm grounds.

Each pod, which includes a bed, sitting area, and bathroom, would cost farmers approximately RMB 80,000 (the equivalent of $13,000). Under the policies of New Rural Construction, they may be able to obtain a loan on preferential, perhaps even interest-free, terms. These terms would give farmers ten years to pay back the loan and reduce their investment to approximately RMB 32,000, or $5,300. With the purchase of a pod, farmers will be able to participate in every aspect of the tourism experience, including food service, housekeeping, activities—and profits.

Affording travelers the comfort and amenities they expect, the pod also provides a built-in measure to ensure sustainability: because farmers purchase the pod through a loan, they are motivated to care for it and their land, so that their farms will continue to draw visitors and yield agricultural produce. Tourists, in turn, are expected to show the same attention to their surroundings. As they engage in a personal relationship with their hosts, they will likely behave responsibly in their environment.

“As the owner of both the farm and the homestay pod, farmers are incentivized to make socially optimal decisions and prevent environmental degradation, as unsustainable tourism would create a cost to their farming business,” says researcher and Stanford Economics Ph.D. candidate Tilky Xu.

Another critical change researchers made to the traditional tourism supply chain was to centralize some operations. Bearing in mind the difficulties of past attempts at rural tourism, researchers made sure to incorporate industry leadership and expertise with the authentic homestay experience. In this combined approach, farmers are responsible for day-to-day operations and interactions with visitors, while key management functions, such as marketing, quality control, and training, are centralized. Under the guidance of the research team and the local tourism bureau, farmers will establish a cooperative to finance this centralized operating platform, which will help ensure a quality homestay experience.

As illustrated below, the revised tourism value chain developed by researchers optimizes participation from the local community, while still welcoming the guidance and expertise of tourism professionals. The result is a profitable and sustainable model that delivers an authentic tourism experience.
Projections from the pilot study show that a pod-based homestay model could increase household income in PuXing between 35 and 55 percent. However, many questions remain. The community itself may not be structured to support this model, as it is fragmented and has little precedent for cooperative organization. In addition, rural property rights in China are undergoing considerable changes, and land issues could erupt if farmland becomes the basis for commercial tourism revenue. Moreover, although this model involves significant participation from farmers, they must still purchase the pods from an outsider, and work with a centralized operating platform that may not have the trust or cooperation of the community.

Researchers plan to address these challenges, and put their homestay model to the test, by building several sample pods in PuXing. At the start of January, the research team embarked on their third field trip to China to prepare to roll out their prototype. If their projections are correct, their test case could turn an impoverished farming community into a rural tourism market offering farmers a sustainable source of supplementary income. More broadly, their study could point the way toward utilizing value chain innovation to increase household income in rural areas around the world.

As this pilot study shows, value chain innovation is instrumental for driving entrepreneurship in developing economies. By tapping underused resources in a rural community, local farmers can become empowered to raise their families out of poverty, while preserving their land and traditions for future generations. Improving the vacation experience for world-weary city dwellers may just be the best way for these famers to improve their lives.

Article by: Melissa Leavitt
Illustrations by: SEED Research Team