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The Globe

PHOTOGRAPH OF MARKET IN AHMEDABAD, INDIA: AFP/GETTY IMAGES

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Searching for that pot of gold in the world's most challenging markets may not be worth your company's while. Here's how to make that call. *by Ashish Karamchandani, Mike Kubzansky, and Nishant Lalwani*

If your company is intrigued by the opportunities at the bottom of the pyramid but hesitant to plunge in, it's not alone: Despite the extent of the markets and the volume of the hype, few multinational firms have built sizable businesses serving people who survive on just a few dollars a day. Companies sense that profits in this market are elusive, and the evidence backs them up.

Apart from some successes in industries such as telecommunications, fast-moving consumer goods, and pharmaceuticals, global corporations have been largely unable to reduce costs and prices enough to serve poor consumers. Our research shows that a only minority of corporations that have engaged with poor populations have created businesses with 100,000 or more customers in Africa or 1 million in India. Procter & Gamble, for example, invested more than $10 million in its PUR water purification powder for bottom-of-the-pyramid markets—but eventually had to shift the product to its philanthropic arm because take-up struggled to exceed 5%. Sourcing from bottom-of-the-pyramid producers is not easy, either. Few companies, our research shows, have successfully integrated large numbers of small, disaggregated suppliers into their value chains.

The bottom of the pyramid clearly isn't for every company—or product or supply chain, even if a company is highly motivated to engage with this population.

Innovations that engage the poor often come not from industry players but from firms outside the mainstream.

Corporations often perceive better options elsewhere. Burgeoning middle classes in developing countries often provide targets that are less complicated to reach and require less alteration to corporations' usual ways of doing business. Similarly, many companies that purchase goods find it easier to deal with large, middle-income farmers or skilled urban workers in emerging markets than with producers at the bottom of the pyramid.

In fact, many innovations that engage the poor have come from players outside the mainstream in their industries. Take the financial sector, for example: Microfinance originated with NGOs, mobile money was developed primarily by telecom companies, and micromortgage companies in India are being launched by entrepreneurs and firms with no experience in the housing-finance sector. Established commercial banks, on the other hand, are usually saddled with legacy systems, fixed assets, regulatory requirements—and, occasionally, mindsets—that make it difficult for them to lead the innovation charge in financial services for the underserved.

But don't be too quick to give up on the bottom of the pyramid. The opportunities are as enticing as the late C.K. Prahalad showed them to be: The 4 billion people living in poverty represent $5 trillion worth of purchasing power. Monitor's research into more than 700 market-based initiatives for social change in India and Africa—drawing on 70-plus site visits as well as interviews with managers, sales teams, distributors, and some 1,500 customers—reveals that the barriers to the low-income market can be overcome. In this article, we'll show the ways in which smart companies have managed to surmount those barriers. We'll also show how innovative thinking has opened new markets.

Barriers in Search of Solutions

Success at the bottom of the pyramid requires companies to adapt their business models for environments that are very different from their core markets. As Prahalad pointed out, much engagement with bottom-of-the-pyramid consumers requires selling low-margin products in high volume. Multinationals often find that their prices are too high for this population, and their usual supply chains, production methods, and delivery systems present formidable hindrances to slashing costs.

Companies seeking to source agricultural products or other goods from the bottom of the pyramid face significant obstacles of their own: Although small-scale growers or decentralized workers are often the lowest-cost producers, the expense of distributing inputs, collecting output, and monitoring and training these far-flung rural suppliers can be prohibitive. For example, Coca-Cola would not have been able to source from small farmers for its juice-processing operations in Uganda and Kenya had it not been for millions of dollars in foundation funds that were committed to the training and organizing of farmers there.

Partnering with NGOs and other organizations that have deep knowledge of customers is often suggested as a way for multinationals to gain knowledge and extend their reach. But many corporate executives have told us that they have abandoned such partnerships. The main reasons: a mismatch in priorities (social versus business), operational differences (differing quality standards, for example), and a perception that partners are not always transparent about their true objectives.

Executives doing business at the bottom of the pyramid recounted the same barriers again and again. Here are some of the most common, along with solutions that have allowed companies to get past them.

Uncertain cash flow. Consumer cash flow is an issue that many companies overlook in their quest to reduce prices. Bottom-of-the-pyramid customers aren't just poor; they live in a state of uncertainty. Up-front payments for certain products are simply out of the question. We found that many small farmers in Kenya, for example, don't buy fertilizer, even though they are aware of its benefits, because they can't afford the 50-kilogram bags it comes in.

Repackaging offerings in small amounts is a well-known way to overcome the cash-flow barrier. Other solutions include using credit (when available) to reduce up-front payments and accepting payment in installments. Pay-per-use strategies allow the customer to pay for use of the asset without bearing the full capital cost. The Muthoot Pappachan Group, one of India's largest gold-loan companies, encourages low-income customers to make small daily payments toward the purchase of gold, which is highly prized by Indians and serves as a savings vehicle. The pay-per-use strategy has been employed successfully in areas such as private primary education in Ghana, irrigation pumps in India, and clean drinking water in the Philippines.

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Another way to significantly reduce costs is to specialize and standardize. Specializing allows a company to eliminate or minimize whole classes of expenses while maintaining acceptable levels of quality. LifeSpring, a joint venture of the nonprofit Acumen Fund and the Indian public-sector corporation HLL Lifecare, operates a chain of 20-bed hospitals for maternity, doctor-assisted childbirth, and early pediatric care in southern India. The facilities, located in low-income neighborhoods, advertise by sending representatives to visit pregnant women in surrounding areas and giving customers discount vouchers to distribute. The hospitals' operations are extremely basic in order to keep costs down, as most patients pay from their pockets. The wards have no air-conditioning, and no food is provided. The company's narrow specialization (complicated cases are referred elsewhere) allows for the use of standard protocols by nurses who have less formal training than nurses in larger hospitals. Wages are thus lower, and there's less churn in staffing, because the demand for these nurses is limited.

Specialization also allows for higher utilization of physicians and a narrower range of supplies. LifeSpring's services cost 65% to 80% less than private-sector options—$90 for a vaginal delivery and $200 for a caesarean, for example.

Do You Have What It Takes?

Here are a few questions executives should ask themselves about their companies before plunging into markets at the bottom of the pyramid.

Can we manage large numbers of low-margin, low-value transactions?

Companies whose business models depend on generating high margins at each stage of the value chain are unlikely to have production and distribution systems suited to low-income markets.

Can we work with informal markets?

A company whose distribution practices are built on, for example, proper trading paperwork or certification of suppliers may feel ill at ease operating at the bottom of the pyramid.

Can we keep out legacy and overhead costs?

Allocated legacy and overhead costs, such as IT, can make new products too expensive for the market and undercut profitability before they have a chance to take off.

Do our leaders have a long-range mind-set?

The low-margin, high-volume businesses at the bottom of the pyramid can take longer to generate healthy returns than those in other markets. Companies need patient sources of capital—many companies we spoke to in Africa cited five years as an expected investment horizon—dedicated teams, and leaders who will champion initiatives despite initial low returns.

Will our organizational culture stifle a bottom-of-the-pyramid innovation?

Initiatives in this market tend to be significant departures from companies' core businesses and thus are vulnerable to being crushed by traditional rules governing new-product development.

Gauging demand. Confusing need with demand is a common problem among organizations serving the bottom of the pyramid. Many firms have wasted time and resources trying to market products that are designed for the poor but that consumers don't want. Our research with microfinance customers in rural India showed that when given a choice between beneficial products, such as solar-powered lanterns and low-energy stoves, and aspirational products like mobile phones and gold coins, 85% of customers opted for the latter.

It's usually difficult to make the economics work for a product if demand must be generated, because marketing costs typically swamp efforts to keep prices extremely low. Companies should focus on areas where they can meet existing demand, with either lower-cost and better-quality products than existing options, or simply cheaper ones. Safaricom's hugely successful M-Pesa, for example, offered money transfers by mobile phone in Africa at 33% of the cost of Western Union—and at 20% of the cost of (and much greater security than) long-distance bus companies, the customary provider.

Sales and distribution challenges. Although customers are numerous, they are often rural and scattered, and it's difficult for corporations to manage the face-to-face (and cash-based) interactions that are typically necessary for building a cost-effective distribution business. Channels built for middle-class and high-income customers, such as agent networks for selling insurance, don't reach the poor—even in urban areas—and extending them can be prohibitively expensive. The challenges go beyond making the initial sale: Multinationals that sell durable goods to villagers often rue the huge costs of meeting service warranties and replacing parts in far-flung locations.

One response to the distribution problem is to build a dedicated channel to serve the market. Innovative companies have found ways to reach low-income consumers through alternative channels that can provide additional value to customers. Some have teamed up with partners that have extensive reach in the market. Hindustan Unilever has difficulty reaching low-income customers and educating them about its Pureit water filters, so it

Managing the Risks

Companies face unique challenges in trying to build businesses at the bottom of the pyramid.

Image

Backlashes over issues such as exploitation—or the appearance of it—can be highly damaging. SKS Microfinance was criticized by Indian politicians and the press after its founders, investors, and top managers made hundreds of millions of dollars in an IPO last year while maintaining that the organization's primary mission was social impact. Demonstrate that commercial returns further community development rather than come at the expense of the poor.

Brand

A low-end version of your brand may reduce its attractiveness in some customers' eyes. Housing developers in India have told us that they worry that building low-income units could cheapen their premium brands. Avoid brand devaluation by creating a distinct name for a bottom-of-the-pyramid product.

Cannibalization

Your new low-cost product may siphon off existing customers. That was the concern of executives of a computer company in Africa, whose ultra-low-cost laptops could cut into demand for the firm's profitable midrange products. Market a bottom-of-the-pyramid product with a differentiated campaign, and, if possible, sell it through different channels.

Underestimating the Competition

Companies often overlook the tough competitors operating within the informal economy. For example, more than 90% of India's juice market is run by small players, many of whom don't conform to quality standards. These competitors may use radical tactics. Reliance, an Indian multinational, stopped selling fresh produce in some supermarkets after street vendors attacked its stores in 2007. Keep local competitors involved by employing them, giving them a role in the value chain, or even sourcing from them.

partners with microfinance institutions. Loan officers aggregate customers into groups, reducing Unilever's cost of marketing, and provide credit, making the product easier to pay for. (Because of microfinance's limited reach in most countries, however, this kind of solution is hardly universal.)

Where such partners are not available, we found innovative organizations improving upon, and distributing through, highly fragmented local networks. Bayer CropScience, a global firm that develops and manufactures crop protection products, used this strategy in Kenya to reach and educate small farmers about its Green World venture. The company introduced small packs of pesticides and trained a network of small, rural agrodealers to form "consultancy centers" that advise farmers on product handling and use. Bayer CropScience provides marketing support via radio and other means. The dealers were selected on the basis of such factors as their reputation in the community and their sales volumes. Kenya has nearly 5,000 agrodealers that stock the products, of which Bayer CropScience enlists only 4%, but Green World's dealers are some of the top performers in the country. About 25% of Bayer's CropScience's horticultural retail revenues in Kenya now come from Green World stores.

Disaggregated providers. Small suppliers rarely have access to high-quality inputs (or the credit to buy them), they often lack training, and their output can be unreliable. Furthermore, companies that provide training and other benefits to suppliers may find that the outputs have been diverted elsewhere through "side selling."

Aggregating and assisting small producers through "contract farming" or other means have been effective in surmounting these problems. Global Green, an arm of Avantha, a $4 billion diversified Indian corporation, provides small farmers with drip irrigation and the inputs needed to grow Spanish gherkins, trains them in best practices, and buys the produce at a predetermined price that typically more than doubles farmers' income. To reduce costs, the company recruits farmers in clusters. It has set up regional processing centers, where the gherkins are cleaned, sorted, and packed for export. Side selling isn't a problem, because there's no local market in gherkins.

Other ways to prevent side selling include active monitoring of suppliers, indexing purchase prices to the market price, and making future participation contingent on compliance. These strategies for using small producers provide significant income increases for participating farmers while generating a steady, low-cost supply for the company that is sourcing. Some 75% of the poultry sector in Brazil relies on contract farming.

Undeveloped business ecosystems. The business ecosystems needed to support a product or service are often missing at the bottom of the pyramid. For example, once a rural entrepreneur has purchased a cow, where does she go for veterinary services? Innovative companies address the holes in the ecosystem by supplementing value chains end-to-end. For example, Amul, an Indian company that buys milk from 3 million dairy farmers, arranged for artificial insemination services for its small producers. Coca-Cola's manual distribution centers, known as MDCs, have been touted as an effective means of getting soft drinks into hard-to-reach urban areas in emerging markets, where infrastructure is poor and volumes are relatively low. What's not well known is that Coca-Cola did not just organize and recruit entrepreneurs to run these centers; it filled all the gaps along the value chain. Distribution-center owners take responsibility only for logistics and fulfillment. Coca-Cola handles such tasks as marketing, supply monitoring, and order taking.

Before Safaricom launched M-Pesa money transfers, it had very basic interactions with retail outlets, which merely sold airtime minutes. But the company's strategy of selling M-Pesa through retail agents required finding ways to manage store selection and the training and supervision of field agents. To do this effectively and at scale, Safaricom now outsources this

Hollard Group revitalized the insurance sector in Africa by selling simple funeral policies, **building a base of 600,000 customers in five years.**

work—for all 17,000 outlets—to Top Image, a specialist in these functions.

Creating New Kinds of Business

The most encouraging business-model innovations at the bottom of the pyramid manage to surmount multiple barriers at the same time. They represent not incremental adaptations but new, groundbreaking, end-to-end strategies.

Consider Voltic, Ghana's market leader in bottled water for middle-income consumers. When it decided to pursue low-income customers in the early 2000s, it chose a radical strategy: selling a premium product in a commodity market. Ghana, like much of West Africa, was already extensively served by informal vendors selling the 500-milliliter plastic pouches known as water sachets. Voltic raised the ante, introducing its Cool Pac brand at a slight premium and touting the product's higher quality.

Controlling costs was a problem, at first. Voltic produced the water centrally at its factory in Accra, but it soon found that the logistics and delivery costs to areas outside the capital were prohibitive, given the poor infrastructure. So the company set up distributed plants with more than a dozen franchisees, who had access to their own capital and an ability to run operations, from managing daily water quality to distributing the product through street hawkers. The franchisees split the operating margins with Voltic, which provided only half of the capital costs, made no investment in trucking capabilities, and retained control over the brand. Nearly half a million Cool Pac sachets are sold every day. (Voltic was acquired in 2009 by SABMiller.)

Hollard Group, an insurance company based in Johannesburg, took a different approach: It entered a largely informal market by developing a unique way of selling and servicing a beneficial product. Life insurance is usually only marginally successful at the bottom of the pyramid. Demand is low, and distribution costs are high. But in 2008, Hollard entered the funeral insurance market in Africa. The continent has a tradition of elaborate and expensive funerals, whose costs were often devastating to poor families. Informal burial societies and others were already providing services for this market, so funeral coverage was hardly a new idea. But Hollard introduced simple policies with affordable monthly premiums and sold them through PEP, a clothing and homewares retailer with 1,100 branches that targets the bottom of the pyramid in South Africa. A policy can be bought at the checkout counter as easily as a batch of cell-phone minutes. Hollard uses text messaging to remind clients about payments, and claims and processing are handled through mobile phones, rather than agents, reducing service costs. Consumers can pay their monthly premiums at any PEP outlet in cash. The firm has created a base of more than 600,000 customers in five years.

Another way to create new businesses at the bottom of the pyramid is to open markets that have been closed to the masses. The housing industry in urban India has boomed during the past decade, but the market serves just the wealthiest 15% of households. Some 40% to 60% of urban residents live in sprawling slums, and many others live in neighborhoods with limited facilities and unhygienic conditions. A new business model developed by Monitor is broadening the sector by bringing new-home costs down to levels that are affordable for people with lower incomes.

Traditionally, developers buy large tracts of land and build in phases. As each phase is constructed, the value of the remaining land increases. The developer staggers construction to maximize returns. This speculative "land as the asset" model results in ever-increasing prices for customers, long project timelines and high, though uncertain, returns for the developer. In contrast, using a low-income housing business model, a developer buys a small land parcel with basic infrastructure (transport availability, markets, and schools nearby) and sells all the housing as soon as building permits are issued. A 20% "down payment" from each customer, collected before a single brick is put in place, covers the cost of the land. The customer finances the rest of the construction, usually through loans from banks or housing finance companies. And the developer makes much of its profit when it delivers the housing. This is a low-capital business with great returns—if the turnaround is rapid. Also, as the profit per house is modest, volume is key. This business model requires a "manufacturing mind-set" and constant innovation that increases quality and reduces costs—in stark contrast to the traditional developer approach.

Some 50,000 low-income houses are estimated to go on sale by March 2011, with prices as low as $6,500. A World Bank study estimated the urban low-income housing market in India to be $220 billion.

FOR COUNTLESS firms, taking on the bottom of the pyramid simply isn't worth the disruption that's required to rethink business models. But for innovative multinationals, the obstacles are far from insurmountable—and the rewards are great.

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