2011

Improving Lives in the Base of Pyramid, Profitably

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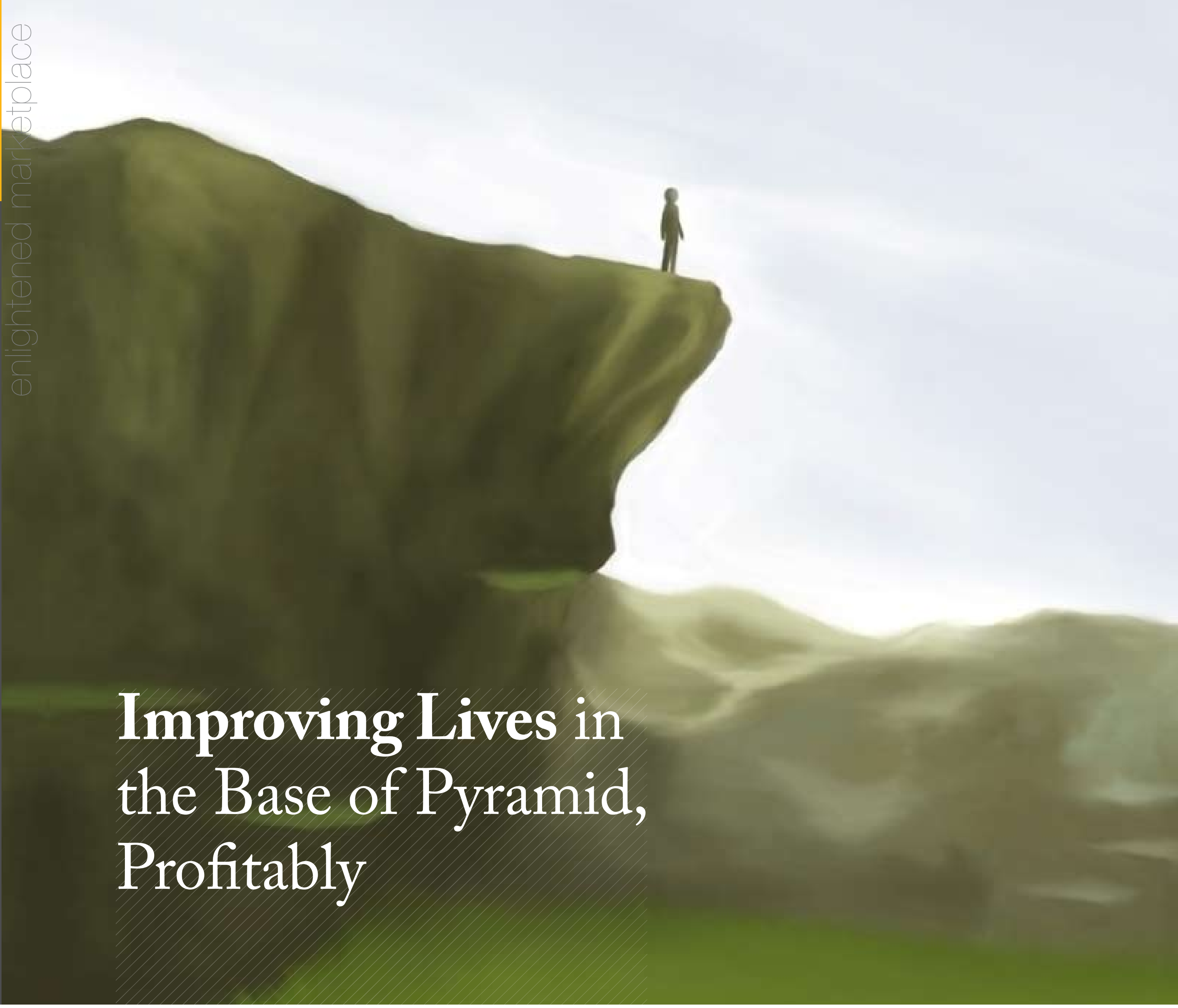

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Stefan Jacob is co-creator of BoP Hub. Working with both large multinationals and small start-ups throughout his career, he is at ease in the boardroom and the village hut. Prior to launching BoP Hub, he worked on several projects with social enterprises in Ethiopia, Mexico and Thailand.

Pin Kwok is co-creator of BoP Hub. She has leveraged her business management and process innovation background in financial services to transition to a career that serves to grow the social impact space. In particular, Pin is working towards scaling proven social innovations and is a proponent of social-business partnerships.

Stefan Jacob and **Pin Kwok** challenge Southeast Asian companies to consider the rewards, and risks, of entering the Base of the Pyramid market.

In just five years, Honda's share of the motorcycle market in Vietnam dropped from 90% to 30%.[1] In the last three years, Nokia has lost over 20% of its once mighty 64% share of the Indian handphone market.

The cause, in both cases? Young Indian and Chinese companies that were created from, and that have adapted to, the resource-poor environments of the Base of Pyramid (BoP) market—in the process, beating big multinationals on both cost and innovation.

These are just a couple of examples of BoP-focused ventures that, in order to compete in their rapidly growing markets,

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are changing entire industries while revolutionising product development, business design and distribution channels. The result: A hugely disruptive force in existing markets.

Rethinking the Bottom-line

Many Southeast Asian firms, however, have yet to tackle these markets. By limiting themselves to just the urban wealthy, these companies are not only in danger of missing out on the fastest growing market, the BoP, but they may also be at risk of losing their current markets to BoP businesses with powerful cost and quality advantages.

Of course, doing business at the base of the pyramid is fraught with challenges. Since consumers who have limited income are naturally very selective, companies have to create and sell potentially higher quality products but certainly at lower cost in order to meet a real social and commercial need. They have to do this through radically different business models and distribution channels. Most often, the key to success is local partnerships and co-creation of products and ventures that allow them to gain deep consumer insights and to tap local resources.

Western companies are already learning this lesson and applying it across the globe. For example, in an effort to improve child health in Bangladesh, Danone partnered with Grameen to produce a low-cost, nutrient-rich yogurt called Shakti Doi ("power yogurt"). The result was a completely local supply chain that now sells 26 million cups a year while dramatically reducing malnutrition rates. Another Western company, Reuters, launched Reuters Market Light (RML), a subscription service that provides weather reports, farming advice and localised pricing in partnership with local mobile operators, non-government organisations (NGOs) and agriculture research centers in India. RML profitably serves several million Indians across 13 states and it has even partnered with Nokia to power its Life Tools platform as the latter fights to regain market share.

Realising the Opportunities in BOP

A number of well-regarded publications, from C.K. Prahalad's case-based *"Fortune at the Bottom of the Pyramid"* to Al Hammond's data-rich *"Next 4 Billion,"* have demonstrated that the BoP has several trillion dollars in spending power that can, potentially, be profitably tapped. The hurdle, however, is that the business elements that most developed world companies rely on—efficiency, high-tech infrastructure, centralised planning, and cutting-edge product design—do not exist or are not useful in the BoP context.

Product development is an excellent example of when traditional business thinking must be overcome. The quickest way to becoming profitable in a low-cost environment is to simply produce a cheaper version of an already existing product. However, BoP consumers are actually more discerning than developed world consumers. Studies show that the average BoP consumer looks at six brands before buying, versus two brands in the West.[2] In the Honda/Vietnam case mentioned earlier, Honda was actually able to regain substantial market share in part because it maintained better quality standards then its Chinese competition, even as it lowered prices to compete.[3]

Consumer giants like Proctor & Gamble (P&G) have already learned this lesson in quality and design. In 2001, the company tried to introduce a lower cost but lower quality version of Pampers into the Chinese market. The initiative failed. Since then, the company has embraced the ethos, "delight, don't dilute." In 2005, P&G partnered with the Beijing Children's Hospital to conduct exhaustive monitoring and evaluation, including 6,800 home visits. The result was a disposable diaper that was drier and more cloth-like, costing half as much as before, and with a marketing campaign that appealed to Chinese mothers. Today, P&G is the market leader in a US$1.4 billion sector that had not even existed before 2005.[4]

This pattern of Western businesses adapting to the local context is repeated in almost every successful BoP business case. In fact, it is often not just the product that needs adaptation; it is also the marketing message, the distribution network and even the core business model. This is where local partnerships and co-creation play a critical role.

The Grameen-Danone project is a perfect example of these principles. Danone had a target price of just US$0.07 for its Shakti Doi yogurt, which meant it had to radically reinvent both its product and its manufacturing. To do this, it decentralised and localised its production, sourcing and distribution. With Grameen's help, Danone sourced from local dairy farmers whom they helped with chilling and transport. It also hired local women to work the factory, which used only minimal technology that focused on quality control, and it sold to local stores using networks of saleswomen that were part of Grameen's existing network.[5]

After four years, Grameen Danone is selling over 26 million cups per year with projections of exponential year-on-year sales growth (it hit 143% in 2010).[6] Although the partnership has agreed not to pay out dividends, it is successful enough that 50 more plants are to be built over the next 10 years. This success was driven in large part by the benefits of partnering with a strong local partner. The access to local networks for both sourcing and distribution paired with local knowledge of consumer needs and desires were critical to building the right business. In addition, Danone's willingness to adapt its production techniques and to co-create its product and even its business with locals was key to its success.

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The Southeast Asian Advantage

Southeast Asian corporations and entrepreneurs are uniquely positioned to build these types of social business partnerships and to enter BoP markets in Asia. They have physical proximity, cultural familiarity and they are accustomed to managing cross-border businesses. These advantages provide an incredible opportunity for growth. BoP markets in Southeast Asia have a population of over 400 million and aggregate income of over US$75 billion. Expand that to all of Asia and the BoP market reaches 2.9 billion people with over US$740 billion in income.[7]

Despite this opportunity, it is difficult to find good examples of BoP businesses in Southeast Asia. This is due, in part, to historical forces—many firms have become successful by serving Western markets using product designs and business practices that, in emerging markets, limit them to only the most affluent customers. There is a cultural element as well. Many Asian executives see solving social needs as the realm of governments and philanthropy, not business. For now, the best examples of social business partnerships still come from other regions like South Asia and Latin America.

In Mexico, Cemex, a cement manufacturing company with US$14 billion in sales, demonstrated the axiom that local companies are often best at both identifying needs and scaling them to a regional level. The company realised that just selling basic building materials to the BoP was resulting in neither better homes nor better sales. So, they created Patrimonio Hoy in partnership with local NGOs and governments. The programme created a complete do-it-yourself package for building a home that is sold one room at a time. Even one room, however, can still be unaffordable, so the solution is sold through female self-help groups that pay for it through a combination of savings and credit from Cemex. Although it took several years to get the programme right, sales in Cemex's low-income segment have tripled and the company has since replicated the programme in Colombia, Costa Rica, Nicaragua and the Dominican Republic.

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In India, many of the corporate giants, from Tata to Infosys, have taken serious interest in serving the BoP. Godrej, a massive commercial and industrial conglomerate, has created a low cost refrigerator tailored to BoP conditions called the ChotuKool. The lightweight and portable device is designed to hold, and can keep cool for hours with no power, a half-dozen bottles of water and a few kilograms of vegetables. At US$69, it is not cheap but still within reach of many small storeowners, delivery people and regular households, especially with help from microfinance institutions.[8]

Tough Challenges

Entering BoP markets, of course, is not without its challenges. Some segments, especially among the ultra poor, will not be reachable through purely commercial models. Even the segments that should be attractive can require years to reach sustainability while being exposed to political and economic shifts. As a result, companies need to think along longer time horizons, be creative about blending for-profit investment with patient capital and philanthropic dollars, and, most importantly, be prepared to fail.

No matter how affordably designed a product is or how innovative a distribution model is, some segments of the BoP just cannot be reached in a sustainable manner. In these instances, BoP ventures may need to rely on non-profit partners or add tiers and cross-subsidisation to their business model.

BRAC, a Bangladeshi NGO, has a category of beneficiaries they call the ultra poor. BRAC is the largest NGO in the

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world and operates 18 social enterprises and three for-profit joint ventures. These generate over US$460 million in revenue a year, which finances over 70% of its operating costs.[9] This is accomplished in part by ensuring that most of its beneficiaries are paying affordable prices for the goods and services it provides and are not just receiving charity. However, when it comes to the ultra poor, these services are often heavily subsidised or free. Even then, BRAC ensures that these programmes are set up to help the ultra poor "graduate" from them when they are independent enough to begin paying for their services.

VisionSpring, a non-profit social business that creates micro-franchises, takes a different approach. Their model of training local women to administer optical tests and sell low-cost eyeglasses was built on the idea that economies of scale would lead to financial sustainability. However, after selling over 200,000 pairs of eyeglass in 2009 and still not covering costs, they realised that they needed a tiered approach to cross-subsidise their markets. Last year, VisionSpring began introducing higher priced glasses for higher income markets. The organisation even went so far as to open a profitable brick and mortar store in El Salvador that sold glasses at upwards of $15 versus $0.95 in other areas.[10]

Even when a market can sustainably support a BoP business, it can take years to build the necessary networks and settle on the right business model. Companies have to be ready to iterate often and fail frequently.

P&G's move into water filtration is a clear example of the lengthy learning curve for a new company entering a BoP market. The company spent years trying to launch PUR, a powdered compound that decontaminates water. They ran small-scale tests in three countries, adjusting their approach after each one, before doing a full pilot in Pakistan. Ultimately, the education and behaviour change required to sell the product proved too financially burdensome to make PUR a commercial product. However, P&G did two critical things that kept PUR from being a major disappointment. First, it kept the early stage testing small and rapid, so that they did not end up with a massive financial failure. Secondly, they had a back-up plan already in place. PUR was transitioned into a not-for-profit that sold the product at cost to other NGOs. This helped strengthen its relationship with potential BoP partners and allowed them to continue to conduct market research on their BoP customers.[11]

Yakult Honsha had similar difficulties introducing its Japanese yogurt drink into the BoP. In 1978, they expanded to the Philippines, using a network of saleswomen to target the poor—a model that had been pioneered in the early 1960s in Japan. However, the company did not adapt the model to local conditions and after three years, the project nearly collapsed. It took a mixed team of Japanese and Filipinos another three years to turn the division back to profitability. As of 2008, these "Yakult Ladies" sold more than a half million bottles a day, generated over US$30 million in revenue per year, and accounted for 40% of total Yakult sales in the Philippines.[12]

Finally, as with any business, navigating the political environment of BoP markets can be difficult. Close ties to government are often essential for getting the local connections and support needed to launch a social business.

Plus, having a strong social component to your business can help build goodwill in local communities and create an incentive for politicians to continue their support. However, two recent events illustrate how elusive a positive commercial outcome can be, even with this support in place.

The political swing against microfinance in Andhra Pradesh, India demonstrates how quickly the tide can turn. Statistical evidence showed that a shockingly high 93% of people in the state were in debt. However, only 11% had loans from MFIs while the rest relied on informal sources like friends or loan sharks, which often have interest rates three or four times higher than the typical MFI. Studies also showed that MFI borrowers had fewer loans overall than those in the informal market. Despite all of this, politicians were able to use anecdotal evidence of over-aggressive MFIs and debt-related suicides to score political points that have nearly collapsed the entire system.[13]

Bangladesh offers a comparative example. Muhammad Yunus has recently run into political trouble with the current government. Although his ousting from Grameen Bank may have been driven by petty political manoeuvres, it stands in stark contrast to a fellow Bangladeshi with a similarly long history in microfinance and development, Sir Fazle Abed. Sir Fazle, the founder of BRAC, has carefully avoided any direct ownership by the government (as is the case with Grameen Bank) and he himself has kept a low profile, preferring to focus on building the brand power of the BRAC name, first at home and now on a global scale.

Unexpected Rewards

Opening new markets and having real social impact are not the only benefits of engaging in BoP businesses. Many companies are realising that innovations in products and business models that are created for BoP markets can be applied to more developed markets. These “reverse innovations” can create huge rewards for daring companies.

Suzlon, India’s top wind power provider, was started by the owner of a textile factory who couldn’t get reliable, affordable energy from the grid. He recognised the huge potential for low-cost, customised wind solutions for factories and rural communities in India. What he didn’t realise was that this was also a huge advantage in more mature markets. From 2004 to 2006, overseas sales of his wind towers jumped from 8% of Suzlon’s revenue to 70% while the company maintained control over 50% of the Indian wind market. Today, the company has over US$4.5 billion in sales in countries ranging from Brazil and China to Australia, Spain, Sweden and the US.[14] The company even bought out its failing turbine supplier, Suedwind, and turned it around while keeping its R&D and manufacturing facilities operating in Germany.[15]

Tata is also realising that its efforts to profitably serve its home market of India may have given it real advantages in competing in Western markets. In 2009, Tata introduced the Nano, an ultra low-cost car that retailed for US$2,500. They were able to do this in large part by leveraging an “open-development model that relied heavily on its suppliers.” This model has given Tata a strong cost advantage versus Western car companies. They have now announced plans to introduce the Nano Europa, which will meet all European regulatory requirements and still sell for less than US$10,000.[16]

The Next Step

So what stands in the way of Southeast Asian companies taking a leading role in the BoP? It is certainly not due to the lack of potential partners. After all, social enterprises are pioneering new products and business models all over the region.

Need a few examples? Hapinoy is building an efficient, low-cost sales network in the Philippines by directly connecting local *sari-sari* shops[17] and cutting out expensive middlemen. They have reached 10,000 shops, and are on their way to 100,000 shops while introducing a range of products from eye-glasses to solar lanterns. Bine Swadaya is an NGO with 40 years of history in Indonesia, during which it has developed over 650,000 community-based groups and 120,000 self-help groups. These two organisations have helped millions build self-reliance, create income opportunities and improve market access.

Other organisations like the World Toilet Organization and Sunlabob, both with offices in Singapore, are changing business models and product design. WTO has created SaniShop, a microfranchise model that trains local entrepreneurs to build low-cost toilets and sell them using emotional and aspirational marketing. They have already successfully piloted in Cambodia and are about to expand into India. Meanwhile, Sunlabob has been changing the way energy products are designed by co-creating with local markets in Laos, Thailand, Afghanistan and Uganda.

There also is no shortage of benefits to existing markets. Frugal medical device design and developments in telemedicine could revolutionise medical markets across the globe. And, as oil prices rise and finding climate change solutions becomes more urgent, off-grid and alternative energy solutions for BoP markets will become highly valuable for more developed markets.

What stands in the way is not lack of opportunity or reward. Ultimately, the next step is for Southeast Asian companies to realise the opportunity that is at their doorstep, learn from others who have already learned the hard way, and have the courage to improve the quality of their neighbours’ lives and alleviate poverty in the region, profitably.

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