insights

Unlocking Value at Bottom of the Pyramid Markets

White Paper

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There's an untapped global 4-billion-consumer market living on US$ 2-5 dollars per day …

This market offers significant profit potential for those players entering it with the right ***strategy, products and business model****. To address them, four fundamental questions arise:*

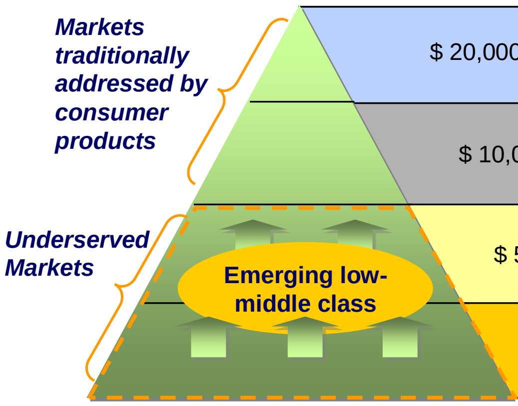
1) What are the unique market dynamics at the bottom of the pyramid?
2) What type of products or services has to be developed to serve consumers in those markets?
3) What type of business models are needed to successfully play?
4) What would be an integrative framework to enter those markets?

What are the BOP markets?

Only three countries in the whole world represent a market of almost two billion at the lowest segments. These markets have been historically neglected by multi-national companies, who have traditionally targeted the upper consumer segments in emerging markets. But low-income consumers represent enormous volume and profit potential for several sectors, starting with those serving basic needs such as food, hygiene and other daily use consumer products. Furthermore, the most important aspect of this consumer segment is not their consumption potential today, but the shift into becoming a low middle-class with higher spending power that will introduce them – in a 10 year horizon- into the global market as new consumers demanding global brands, products and services.

To serve these markets, two basic pre-conditions need to be fulfilled by international companies: 1) Creating the capacity to consume, and 2) Developing products and services adapted to their pockets and lifestyles. Let's look at the "Market Pyramid" in some of the most representative countries.

Figure 7: The Market Pyramid in China, India and Brazil[1]



Purchasing Power (US dollars, per year)	Population (in millions) China	India	Brazil
$ 20,000+	2	7	9
$ 10,000 to $ 20,000	60	63	15
$ 5,000 to $ 10,000	330	125	27
Less than $ 5,000	800	700	105

Other markets also present large populations of bottom of the pyramid consumers, especially in Asia and Latin America. Africa presents few examples yet as poverty alleviation and basic needs fulfillment is still at very early stages. Indonesia, Thailand, the Philippines, Venezuela, Ecuador, Colombia are only a small sample of geographic concentrations of BOP markets.

Overall, the five billion poor people that take part in this market, represent $14 trillion in purchasing power, more than Germany, the UK, Italy, France and Japan together.[2]

A study conducted by Deloitte among global manufacturers also confirms that executives see future growth coming from emerging markets.

[1] Source: Adapted from C.K. Prahalad & K. Lieberthal, "The End of Corporate Imperialism", Harvard Business Review, Aug. 2003
[2] Source : Fast Company Magazine interview to C.K.Prahalad, January 2005 issue

What are the determinant market conditions?

A consumer landscape dramatically different from that in the west

Several assumptions have been made in the past about these type of consumers, mostly based on the model of consumers from the developed world. But research shows that once again, BOP consumers cannot be measured with the same indicators as consumers in the west. Some of the characteristics of these consumers are:

- *The poor are brand conscious, but also extremely value-conscious*[3]
  BOP consumers are by necessity, focused on obtaining a high quality and performance for the price they can afford to pay. Yet, brands are also important, as they represent the "aspirational" lifestyle they expect to achieve. That poses challenges to manufacturers in terms of improving research, production and distribution costs and achieving higher levels of operational efficiency.

- *BOP consumers live on earnings made day-by-day (and don't use credit cards)*
  That means that their purchases are for the short term and they don't have the cash to afford large family packs. Successful companies like Hindustan Lever turned this constraint into an opportunity, developing single-sized packages for personal care products, which are sold at an affordable price and high profits.

- *BOP consumers are early adopters of technological innovations*
  Wireless devices, mobile phones, PC kiosks and Personal Digital Assistants are widely spread and used in India for example. The lack of infrastructure in villages has pushed for collective initiatives that successfully made individuals adopt technology naturally. In Kerala, fishermen in basic fishing boats sell their catch at the end of the day using mobile phones to contact possible sites to dock along the coast.

Understanding prevalent market dynamics and practices

- *BOP markets are highly connected…*
  China and India are the fastest growing cell phone markets in the world. At the end of 2003, China had an installed handset base of 250 million, whilst India had 30 million and Brazil 40 million. [4] That suggests that these markets are going to drive wireless applications growth. Manufacturers have largely adapted to the nature of these markets, by adapting their product offering, pricing and developing multiple financing formulas for individuals to access products.

- *But the time frame for product development and consumer adoption is slower than in the west…*
  Given the size of the territory and the large distances among cities in countries like India, timing has a total different dimension for individuals. Their way of living also has far less variation, especially in rural environments. That, coupled with the poor access to communications in some areas means that consumer adoption cycles can take longer than in the developed market

- *Therefore, the process of implementing a business model may take more time…*
  …as it may require several iterations. But iterations in these markets are harder to pace, as customer insights collection may be a long and painful process.

A challenging regulatory environment and quality of infrastructure

- *The regulatory environment is improving, but red tape continues to abound in emerging markets*
  Companies operating in emerging markets still find that regulatory environments are not fully suitable to accommodate international companies. Contracts tend to be insufficient, courts slow to act and there is still corruption at several levels.

- *Sourcing can be problematic in some industries*
  Demands for quality and traceability in sourcing cannot always be fulfilled in BOP markets, especially in food sectors. Some companies such as Unilever in Indonesia have taken steps to developing a reliable network of suppliers, investing in education and technology to achieve required quality standards.

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[3] C.K. Prahalad, The Fortune at the Bottom of the Pyramid, Eradicating Poverty through Profits, Wharton School Publishing

[4] Ibid

- *Transport infrastructure is inefficient and under-developed in most BOP markets*
  The quality of roads and infrastructure is still insufficient, hindering fluidity of business and restraining sourcing and distribution to and from isolated areas.

- *Distribution in rural markets is hard to orchestrate*
  Access to remote areas is problematic, even for media and telecommunications. The spread of wireless connectivity may be a solution, but it will take time. Yet, solutions need to be developed when dealing with long distances and specific conditions, such as maintaining the cold chain in certain food products.

- *But BOP populations also concentrate on urban centers*
  …this allows for extensive distribution opportunities. It is expected that in 2015 there will be 368 cities in the developing world that will have more than one million people in each. It is also anticipated that there will be at least 23 cities with a population of over 10 million, of which 40% will be BOP consumers.

Despite the constraints, the opportunities and rewards can be enormous

Emerging markets provide unique opportunities for disruptive business models, as they present characteristics that make them ideal for experimentation:

- *They are better markets to identify and pursue growth opportunities*
  These markets remain "virgin" in many sectors and consumers are avid for products and services that provide solutions suitable for their lifestyle, needs and preferences. These markets present the largest scope of consumers that are being underserved or not served at all by an existing product.

- *Successful developments can be applied profitably in other markets more than those created for high-income markets*
  As products created for those markets are developed under several constraints, maximum asset utilization and with the lowest possible cost structure to maximize profits, rolling them out in other markets requires far less resources than doing the opposite. For example, P&G developed Pampers wipes in emerging markets first, to then apply the same concept in western markets.

- *Those that succeed, can win big*
  Markets such as India offer enormous opportunity. Multinationals are on average, more profitable than their local counterparts[5]. Furthermore, Indian branches of some international companies have earned significantly higher return on capital employed (ROCE) than their parent companies. LG, for instance, derives 20 percent of its global revenues from India. Even more, the company expects that 40 percent of the appliances sold in the Middle East will be manufactured in India.

Learning to look at BOP markets trough new lenses

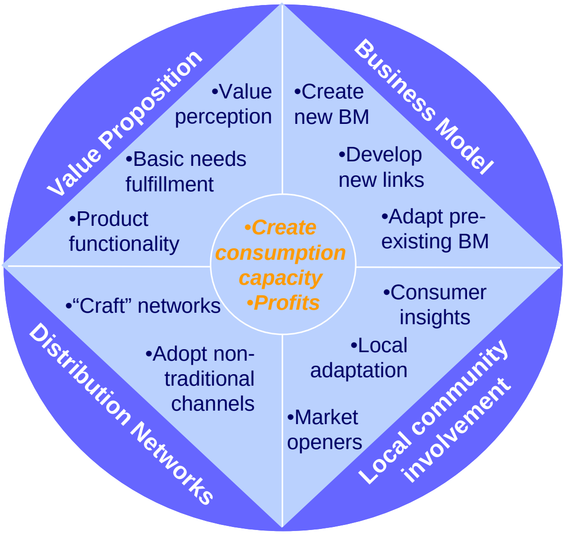
Research conducted among foreign companies in low-income markets shows successful multinationals share at least three characteristics.[6] First, they have taken a long-term approach to the market, which can be seen through their investments, strategy and operational model. Markets such as India or China tend to be taken as the "flavor of the month", which is a mistake, given that success in these markets requires a high level of commitment from management in understanding the local realities and being able to deploy suitable models.

Second, successful companies have either adapted or totally re-formulated their business models to fit local conditions. Products and supply chains must be redesigned in order to cut costs due to low local prices. Distribution systems must be uniquely crafted and tailored to local transport, road and geographic conditions.

And third, through their products, successful companies have dramatically re-shaped the local industry landscape and the market.

[5] BCG Benchmarking Study, Latitude Analysis
[6] "What executives are asking about India", McKinsey Quarterly 2005

With that in mind, our model to approach those markets is based on four key elements: value proposition, business model, distribution networks and local community involvement.



An Innovative Value Proposition

Further to adapting foreign products or value propositions, companies that have remarkably succeeded in these markets are those able to develop completely new value propositions. Why? Because instead of adapting a product or service that was designed with a western consumer in mind, they started by looking at the local consumers, their habits, preferences, needs and way of living to then develop products or services that fit that unique consumer portrait.

Understanding those needs and ways of living and using products requires deep customer knowledge and insight. Investing in understanding these consumers can be highly rewarding for companies seeking to enter low-income markets. Techniques such as experiential marketing through point-of-purchase and point-of-use observation are being largely used in order to both gain insight into consumer needs and assess how to better pack, deliver and market products to consumers.

But there is no single, uniform value perception in low-income markets. Key purchasing criteria can substantially vary within BOP markets for two reasons: one, there is no single BOP market, but various different customer sub-segments that take part and second, dimensions of product performance can significantly differ based on the product category and on local reality.

It is only a myth that price is the single most important criteria in choosing which products to buy, consumers in these markets don't always opt for the cheapest offering. Functionality, convenience and quality tend to be important common dimensions across markets. Chinese white goods manufacturer Haier has developed a small size refrigerator for the Indian market that sells at US$ 20, it is not only low-price, but it also contemplates living space constraints. But what does matter to them is that due to their limited and unstable cash flow, they shop daily and make small purchases. In addition, due to limited living space, storage is not available for large "family pack" purchases. This is especially evident in hygiene and "aspirational" products which have a higher cost. To respond to that, Unilever developed in India single-serve sachets of shampoo, which are higher in unit price but make it possible for consumers to buy just the quantity needed instead of a larger, more costly bottle. Nokia and Motorola, which together hold more than 60 percent of the mobile phone market in India, offer handsets priced under US$ 50.

Unconventional Business Models

To succeed in those markets, companies need to entirely re-think and re-design the business model, not just the product offering. Furthermore, we believe that the most successful business models in these markets require a disruptive approach, as they demand a full depart from traditional ways of thinking about customers, product features and pricing. For many western multi-national companies, this process requires "unlearning" much of what has made them successful in order to develop and commercialize far less expensive products that meet the needs of consumers and businesses in emerging markets.[7]

Citibank has operated in Zambia with three branches since 1979 offering consumer and business banking services, yet it has struggled in the consumer sector[8]. Zambians need frequent access to their meager savings, something difficult to achieve with three branches. In response, Citibank emphasized corporate banking, but has only succeeded with large multinationals, not with local corporate customers, who do not value Citibank's long-term investment and lending services because they need to optimize use of cash-in-hand. In contrast, local player Finance Bank has rapidly grown with a completely different model. Initially, it targeted the consumer market and built over 40 branches. It invested in an ATM system, it accepts small transactions and makes money on service fees, earning from a high volume of transactions. Later on, the bank saw that its network could be of value to businesses and developed simple services such as safekeeping for cellular operators' pre-paid cards or enabling wholesalers to pay suppliers at the banks' branches, avoiding cash transactions in the street. Even though many of Citibank's products were similar to those of Finance Bank's, the first's business model was not appropriate for the local market, in which success demanded focusing on solutions for a high volume of small transactions and diversified revenue streams.

Innovation at all Levels

Low-income markets offer great opportunity to act as innovation labs. Global manufacturers can effectively leverage from their worldwide capabilities to develop potentially "disruptive" innovations that create new market spaces by addressing un-served or under-served needs of customers. But this task also requires going beyond their traditional innovation strategies targeted at developed markets.

Many manufacturers are re-locating R&D facilities and innovation centers in emerging markets, but not only to reduce costs, but to absorb local needs and expertise into local product development. The proximity to customers and suppliers is a key element in product development for low-income markets.

Procter & Gamble now spends 30% of its $1.9 billion R&D budget on designing products for low-income consumers. In some of their research centers, the company developed laboratories that recreate the natural temperature and humidity conditions found in Mexico and China.[9]

Collaborative and Sustainable Value Chains

Crafting efficient inbound and outbound supply chains also represent a critical challenge in poor markets. This has pushed for innovation in these areas too, especially in logistics and sourcing which can be hard to orchestrate. Instead of buying from traders and middlemen, several companies in the consumer goods and packaged foods have developed alternative supply chains that ensure a continued supply of raw materials and reduce costs along the value chain. Companies such as Nestle and PepsiCo have integrated their sourcing networks all the way back to the villages in India, putting together pools of farmers to whom they provide assistance to achieve the quality standards required. Unilever Indonesia has also orchestrated an alternative supply chain for its "Kecap Bango" soy sauce, by constituting a pool of farmers that receive training and financing in order to become suppliers of black soybean to the company. To date, the program reunites over 1,000 farmers.

Alternative Distribution Networks

In countries that are more developed, distribution channels tend to be established, and reaching the market is just about finding a distribution partner. Companies with standardized products can also rely on agents and alliances to create their distribution channels. Some companies with more complex offerings instead seek partnerships with distributors to reduce risks and lower costs of service. But there may be several opportunities that other actors let forgo.

[7] Laboratories of Innovation: Leveraging Emerging Markets for Commercial Success, Deloitte White Paper
[8] Strategy & Innovation, July-August 2006, Volume 4
[9] "The Switch to the Lower-Income Consumer" and "Check the Depth of the New Customer's Pocket", Financial Times, November 16, 2005

The complexity of low-income markets, especially in geographically dispersed areas, where big retail surfaces are not developed and consumers still prefer buying from small local stores, together with underdeveloped infrastructure, has pushed several players to rethink their distribution strategies.

Developing new distribution channels in BOP markets requires too creative and non-traditional approaches. Many companies work with highly complex distribution systems, comprised of hundreds of distributors, wholesalers and agents. It is worth considering that the distribution structure significantly varies from one city to another, especially from large metropolitan areas to smaller villages and rural ones. LG, for instance, parks its own vans next to general retail kiosks in rural India to make product demonstrations and take orders. P&G has created its own distribution network in some rural areas, by financing the purchase of motorcycles to potential "agents".

Building the distribution network locally requires:[10]

- Enticing entrepreneurs to invest in the necessary technology to place orders, hold stock, break bulk and make deliveries to remote locations
- Making sure that supplies needed are available and easily accessible in the country
- Training would-be entrepreneurs and helping them get started with seed financing
- Gaining trust from local established entrepreneurs to upgrade their standards of quality in manufacturing, sales or customer service
- Creating original sales channels by leveraging established or potential networks such as entrepreneurial women
- Educating dealers and after-sales technicians on new practices such as warranties

Go-to-market dynamics may radically differ from one product type to another. Distributing cell phones may face different challenges as delivering toothpaste. When Colgate decided to enter the Zambian market, it took a moderate approach, taking time to learn about the market and building partnerships to introduce the brand. Contrary to most consumer brands that launch in the capital first, Colgate introduced some products in a small and relatively isolated region. There, an "on-the-ground" team learned about the market and tested distributors. Instead of developing a traditional manufacturer-distributor arms-length relationship, the company used a small group of captive distributors through which it expanded into other areas.

New Pools of Talent

Once regarded as supply markets for low labor cost, today emerging markets are facing the talent shortage as much as the developed world. One of the managers that we interviewed in India stated that one of his main concerns was how to maintain local personnel rotation below reasonable levels. To leverage from their internal pool of expertise and global experience, companies must assemble global resources that ensure efficient cross-cultural teams that take advantage of the companies' collective competencies.

Overall, companies need to re-think their recruitment and talent retention strategies when entering these markets, as well as the global capabilities, cultural and skills mix needed to bring together in order to ensure success. HSBC, for example, has a global program through which it rotates 400 handpicked international managers throughout the world. In this program, the company provides training focused on tolerance and cultural awareness, as well as on the challenges of running international complex businesses. This type of program is aimed at producing managers that are embedded enough with the company's corporate values, strategy and operational model, but flexible enough to adapt to and successfully deal with new situations.

Unparallel Opportunity for Integration of Local Community

For all of the above to work together, we believe the last piece of the puzzle is the local community involvement, creating clusters that include research institutes, NGOs, suppliers and other constituencies that can increase the impact of the innovations in those markets.

[10] Business Models for Technology in the Developing World, California Management Review, Vol. 48, No.3, Spring 2006

Involvement of the local community becomes particularly important when orchestrating the value chain. These markets command severely efficient global value chains in order to deliver lower prices. A recent survey shows that companies that have successfully mastered the growing complexity of their value chains are up to 50 percent more profitable than others[11].

As sales in emerging markets expand, companies will need to balance managing efficient global value chains while integrating local resources. One approach is developing “micro-networks” at a local level than can flexibly integrate local suppliers to global platforms that provide expertise and efficiency. A fundamental issue to sort out in local sourcing is reliability (quality standards, volume, technology) and how we can integrate local agricultural producers or entrepreneurs in other areas be incorporated into the value chain.

Local community involvement can be critical in architecturing distribution networks. Many companies have developed their networks by integrating local networks of entrepreneurs, especially women, and training them to sell.

Local community involvement can also play a fundamental role in poverty alleviation in these markets by integrating different actors that can act as catalysts for change. For instance, Unilever assembled and trained 150 women from 50 villages to directly sell their products to friends or community groups like Avon or Amway do, which marks a radical departure from Unilever’s stratified distribution channels and highly trained sales reps model.

Involving NGOs can also help gain insights and knowledge on the market and facilitate the design of the business model. There is a new breed of market-oriented NGOs that are business-savvy and results-oriented, they understand the environment of developing markets and can assist come up with successful business models. These also understand that private sector can provide them with sustainability for their organizations; so more often so, we are seeing these type of partnerships.

Voice and advice can also be obtained from establishing formal advisory relationships with local or regional governments and important local leaders, which in some areas can be even tribal leaders.

[11] Source: Deloitte