

2 Phenomenological background for the BoP

The concepts of user and consumer innovation originate from developed markets and build on wealthier, resource-rich consumers. To investigate the concepts in a completely different context at the so-called Base of the Pyramid (BoP), phenomenological foundations of the BoP shall in the following lay the groundwork and define the research context for the present dissertation. This section starts with fundamental definitions of the term that refer to a population group and a business concept at the same time. General benefits and concerns associated with doing business with the poor are discussed before portraying the economic living conditions of the poor and depicting the challenges associated with doing business in a BoP environment. Finally I highlight the importance of innovation to successfully serve subsistence markets and introduce approaches guiding BoP innovation efforts before concluding that innovation for and at the BoP requires participation of the poor themselves.

2.1 Definition and background of the Base of the Pyramid

2.1.1 Population group

From a demographic point of view the BoP describes a population group living in various, mainly underdeveloped or developing countries in the world. Their common denominator responsible for the nomenclature consists in their low income levels. If one sorts the world's population by their yearly or daily disposable income as well as by their quantity, one will obtain a roughly pyramid-like shaped distribution with very few wealthy people at the top and a huge base of poor people at the bottom. These poorest people of the poor represent the lowest level of the global income pyramid and are, therefore, referred to as the bottom of the pyramid (Prahalad, Hart 2002; Prahalad 2010). Given the negative connotations of the word "bottom," several additional terms such as "low income market," "subsistence markets" and "low-income segments" are used alternatively (Nakata, Weidner 2012; Hammond et al. 2007). In order to stay close to the original notion of "bottom of the pyramid" introduced by Prahalad and Hart (2002) but to avoid negative connotations, I will use the term "Base of the Pyramid," which is consistent with, for example, Simanis et al. (2008).

At different points in time authors and institutions have proposed diverse income thresholds to define the BoP and estimate diverging BoP population sizes and

purchasing power.¹ I focus hereinafter on defining thresholds² and BoP population size estimates by the World Bank (World Bank 2012). Accordingly, in 2008 there were roughly 1,3 billion people (19% of the world population) living at \$1,25 or less per day per capita and 2,4 billion people (36% of the world population) living at \$2 or less per day per capita (see Figure 1).

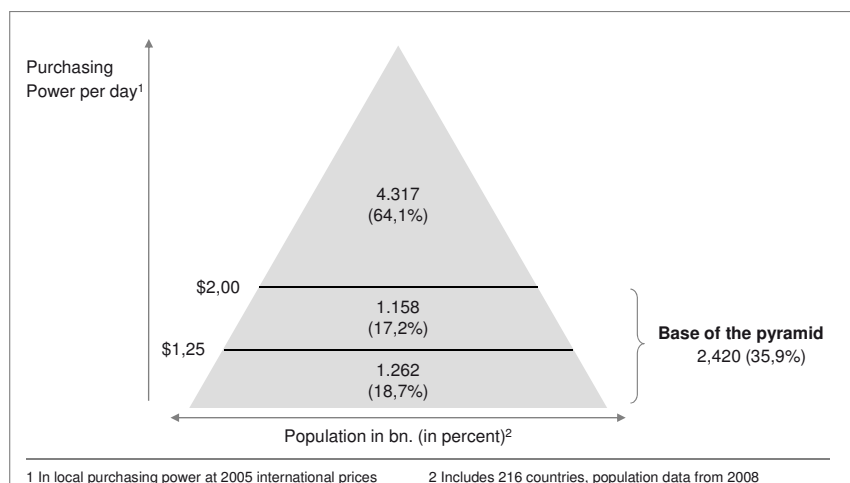


Figure 1: The global income pyramid (cf. World Bank 2012)

While income is the most commonly used indicator to identify the BoP as well as its eponym, it bears certain weaknesses. There is no consensus on where to draw the exact poverty line and minor alterations of thresholds have major impact on the size of the population group. Purchasing power exchange rates are criticized for their missing actuality and inaccuracy as the poor may face manifold price differences, e.g. between rural and urban areas. Consumption is considered as a better indicator for poverty but the extend of vital consumption is relative and depends on factors such as geographic and climate conditions. Finally, income and consumption patterns account only to a limited extend for the effects of household size, integration

¹ Prahalad and Hart (2002) suggest more than a billion people live at less than \$1 income per day per capita in local purchasing power and define the BoP at the same time as 4 billion people with an annual income per capita of less than \$1.500. Prahalad and Hammond (2002) estimate 4 billion people at the BoP but with an income threshold of \$2.000 annual income per capita. Banerjee and Duflo (2007) adopt a poverty line of \$1,08 per day per capita whereas Karnani (2006a) defines a threshold of \$2 per day per capita.

² All following income thresholds correspond to the dollar amount in local purchasing power.

and embeddedness into the community (cf. Karnani 2006b; Banerjee, Duflo 2007; Gradl, Knobloch 2009).

The shared problems of the people at the BoP are a better means of describing poverty (Gradl, Knobloch 2009). Sen (2001) put forward a holistic and widely accepted concept also known as “the theory of poverty” that characterizes poverty as deprivations in capabilities. Sen’s capability perspective does not deny but enhances the income driven identification of poverty given that “... low income is clearly one of the major causes of poverty, since lack of income can be a principal reason for a person’s capability deprivation” (Sen 2001, p. 87). Poverty represents a person’s economic, knowledge, physical, and psychosocial deprivations in capabilities that ultimately result in deprivations in chances and choices in life. These deprivations include basic needs such as food, education, and physical health as well as social isolation, psychological stress and chances for self-realization. For example, better basic education and health can improve one’s quality in life and ability to earn money and offers more job options to choose from (Evans 2002; Sen 2001; Nakata, Weidner 2012).

The BoP from a development and economic perspective, therefore, focuses on shared unmet needs and deprivations. It targets a population group that exceeds the population share defined by BoP income thresholds only (Gradl, Knobloch 2009). The International Finance Corporations (IFC) and World Resources Institute (WRI) (Hammond et al. 2007) recommend considering a larger segment of the poor population for a market-oriented approach. According to this recommendation, roughly 4 billion people at the BoP with a yearly per capita income below \$3.000 dispose of a combined purchasing power of \$5 trillion (see Figure 2). Their daily per capita income corresponds to \$3.35 in Brazil, \$2.11 in China, and \$1.56 in India in USD (2005). In their report the International Finance Corporations and World Resources Institute find that these 4 billion people share the following three major characteristics: 1) significant and unsatisfied needs for food, access to water, electricity, and health care, 2) their dependence on subsistence markets without access to formal labor markets and opportunities to sell their crops and crafts at fair and controlled conditions, and finally 3) being exposed to poverty penalties, which means that the poor have to pay even higher prices for basic goods, such as water and energy than wealthier people in the formal economy (Hammond et al. 2007).

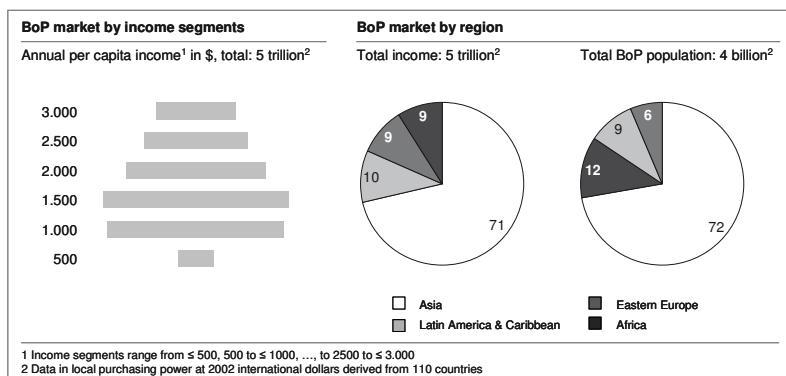


Figure 2: BoP market size (cf. Hammond et al. 2007)

However, the BoP is not a homogenous group. There are a lot of sub-segments at the BoP that differ with regard to their income level and consumption patterns within the defined threshold (Guesalaga, Marshall 2008). People living on \$500 to \$2,000 annually per capita provide most of total BoP purchasing power, whereas the least is provided by the poorest of the BoP living on less than \$500 annually per capita (see Figure 2). Over 70% of the BoP population lives in Asia followed by Africa (12%), Latin America and the Caribbean (9%), and finally Eastern Europe (6%) (Hammond et al. 2007). These people experience different geographic, cultural, political and religious conditions, which consequently cause divergent problems, needs, and preferences (cf. Guesalaga, Marshall 2008; Banerjee, Duflo 2007).

2.1.2 Business concept

C. K. Prahalad and S. L. Hart (2002) who introduced the concept in 1998 in a working paper version of their later paper, "The Fortune at the Bottom of the Pyramid", first used the term BoP with reference to the underlying business concept. The idea was predominantly popularized by C. K. Prahalad's book of the same title (Prahalad 2010) that enjoyed great attention throughout the world (e.g. London et al. 2010; Viswanathan, Sridharan 2012; Davidson 2009). The BoP concept emphasizes an economic view on the population group and understands it as a large and so far mainly untapped market that offers profitable business opportunities to companies whose realization contributes at the same time to the development of the poor (Prahalad 2010). Thus companies are "...serving an unserved market and alleviating the level of global poverty while still earning a profit" (Pitta et al. 2008, p. 393).

2.1.2.1 Benefits to the private sector

Over the last years companies have shifted their focus increasingly to emerging markets as sources for economic growth (Arnold, Quelch 1998; The Economist 2010e). According to a special report on emerging markets by *The Economist* "...Western multinationals are investing ever bigger hopes in emerging markets. They regard them as sources of economic growth and high-quality brainpower..." (The Economist 2010e, p. 1). While the developed countries experience sluggish and stagnant growth still struggling with the current crisis, the developing world enjoys high growth rates and bright prospects (see Figure 3) with its huge emerging consumer base that no multinational corporation (MNC) can ignore (Prahalad, Lieberthal 1998). The IMF (International Monetary Fund 2011) estimated a worldwide real GDP growth rate of 5,0% for 2010, while the emerging countries contribute an overall 7,3% GDP increase (e.g. Asia grew by 9,5%, Latin America by 6,1% and Sub-Saharan Africa by 5,0%). These growth rates contrast with a relatively low overall GDP increase of 3,0% across the advanced economies (e.g. 2,8% in the USA and 1,7% in the Euro area).

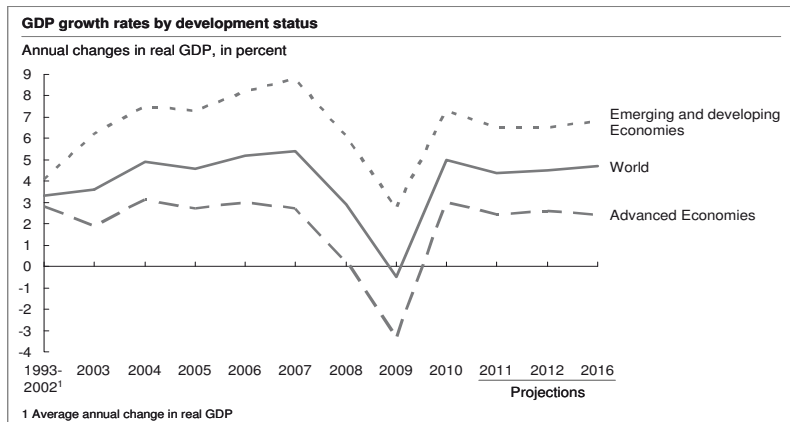


Figure 3: GDP growth rates (cf. International Monetary Fund 2011)

The emerging markets not only represent "...the major growth opportunity in the evolving world economic order" (Arnold, Quelch 1998, p. 7) but also its immense and further growing population paired with the expected economic development promises that several hundreds of millions of consumers will enter the middle class in the near future (The Economist 2010e). In this context companies intending to operate in emerging countries can hardly ignore the 4 billion people living at the BoP. According

to Guesalaga and Marshall (2008), people living at the BoP control more than half of the total purchasing power in developing countries (see Figure 4). To companies the BoP represents a huge market with a purchasing power of approximately \$5 trillion (see Figure 2), which roughly corresponds to the combined GDP of Germany and Italy³ (World Bank 2012) playing a central role in the growing and attractive emerging markets. Additionally, doing business at the BoP offers companies a competitive advantage by tapping into a huge market with very limited competition, as it has so far largely been ignored by the private sector (Hammond, Prahalad 2004). An early entry into the BoP market allows benefiting from first-mover advantages and optimizing market presence and positioning for the BoP's anticipated move toward the middle class and appearance of local and global competitors (Prahalad 2012; The Economist 2010c).

Companies challenging the "largest remaining global market frontier for businesses" (Nakata, Weidner 2012, p. 21) have the opportunity to tap into this \$5 trillion market and to enjoy profits despite the individual consumer's poverty. High volume products and services at minimal profit margins enabled SKS Microfinance to generate considerable overall profit through lending approximately \$725 million in microloans to more than 2 million Indians living at the BoP over a period of ten years (Akula 2008). Among multiple other examples Prahalad (2010) refers to Aravind Eye Care System in India who performs around 200.000 cataract surgeries per year at a very low prices compared to the developed world (prices are between 25% and 50% of comparable surgery costs in the USA). Even though the poorest 60% of its patients receive free surgery, Aravind nevertheless operates very profitably.

³ GDP at local Purchasing Power Parity in 2010.

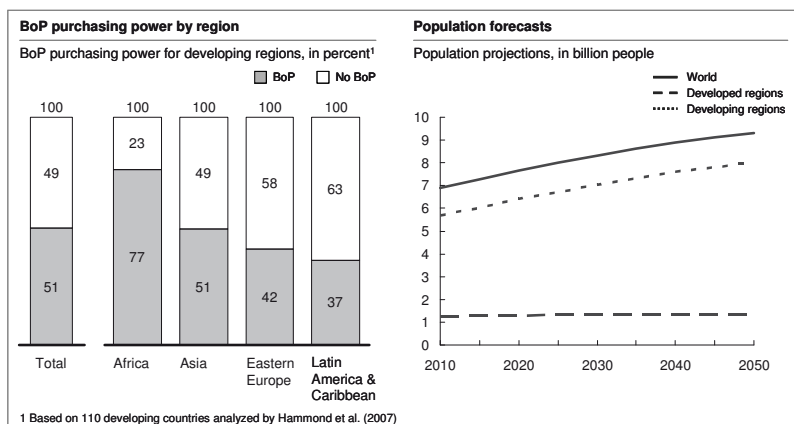


Figure 4: BoP purchasing power and global population forecasts (cf. Guesalaga, Marshall 2008; United Nations Population Division 2010; Hammond et al. 2007)

Furthermore, doing business at the BoP can benefit companies in regard to their corporate social responsibility (CSR) activities. Nowadays companies experience more and more pressure to behave as a “good citizen” and to responsibly address the environmental and social consequences of their business (cf. London, Hart 2004; Porter, Kramer 2006). According to a recent study by the MIT Sloan Management Review and The Boston Consulting Group (MIT Sloan Management Review, The Boston Consulting Group 2012) nearly 70% of 3.000 responding executives from 113 different countries confirm that sustainability, more specifically environmental, economic and societal sustainability, figures permanently on their companies’ management agendas. Of the 250 largest MNCs in the world, 64% published separate CSR reports in 2005 (Porter, Kramer 2006). The engagement into BoP business is recognized as an important CSR activity (Hart, Milstein 2003). This fits well Porter’s and Kramer’s (2006) three major social issue categories for CSR strategies: 1) the generic social issue that is poverty and depending on the respective company’s activities it can furthermore involve 2) value chain social impacts whenever the firm’s business operations affect emerging markets and the BoP, and finally 3) social dimensions of competitive context if a competitive advantage can be derived e.g. through an early presence in the developing BoP market. CSR is not just charity or business constraints, but it can be “a source of opportunity, innovation, and competitive advantage” (Porter, Kramer 2006, p. 80). Eccles et al. (2011) find that highly sustainable companies adopting a large number of CSR strategies and policies outperform their less sustainably operating peers and achieve higher rates of return. Publication of a company’s BoP activities allows a boost to the company’s

reputation and contributes to an improved image and its general publicity. To various stakeholders, from suppliers to the broad public and to the end consumer, the firm appears more appealing and trustworthy to conduct business morally. The involvement into CSR and BoP operations can play an important role with regard to employee recruitment, retention and motivation, since employees value social commitment and their identification with the firm increases (Gradl, Knobloch 2009; Porter, Kramer 2006).

2.1.2.2 Benefits to the people living at the BoP

In 2000 for the first time the United Nations formulated clear targets to abate deprivation suffered at the BoP by means of the Millennium Development Goals (United Nations 2005) destined to help people in extreme poverty. The eight overarching goals cover the following targets to be achieved by 2015: 1) reducing the number of people in severe poverty, 2) achieving primary education for boys and girls, 3) promoting gender equality, 4) decreasing child mortality, 5) ameliorating maternal health, 6) fighting diseases, 7) developing environmental sustainability, and 8) establishing a global community for development. The latest progress report published in 2010 (United Nations 2010) shows clear signs of overall improvement with only 27% of the population in developing countries living on less than \$1,25 per day per capita in 2005 compared to 46% in 1990.⁴ This trend has been mainly driven by strong growth in Eastern Asia. Nevertheless, “the poorest groups, those without education or living in more remote areas, have been neglected and not provided the conditions to improve their lives” (United Nations 2010, p. 4).

Traditional approaches to poverty alleviation are based on the underlying assumption that people at the BoP are helpless, unable to improve their situation by themselves and without opportunities to make their own decisions. Accordingly, BoP people are considered as passive recipients of development aid and charity (Hammond et al. 2007). However, over the last years traditional methods alone have not proven to be successful and no further long-lasting and sustainable effects can be expected from charity and pure development aid actions (Hahn 2009). Ignored by the traditional assumptions, the BoP is in reality engaged in market processes and regular trades, e.g. money and manpower in their informal market environment. The concept of BoP recognizes this and aims to turn them into more comprehensive and competitive, inclusive and fair market processes (Hammond et al. 2007). The BoP concept shifts the view from helpless and passive development aid recipients to resourceful and

⁴ This corresponds to 1,8 billion people in 1990 and 1,4 billion people in 2005 (United Nations 2010).

active consumers, producers and even entrepreneurs "... who possess valuable knowledge, resources, and capabilities" (Dos Santos et al. 2009, p. 80). The involvement of the private sector enables traditional approaches to join forces with commercial activities. The private sector can apply their unique resources to fight poverty. Firms have access to considerable scale opportunities, specific know-how and skills as well as substantial financial, managerial and technological resources that can be employed to offer affordable products and services to the BoP (Prahalad, Hart 2002). By addressing the significant and unmet needs of the poor and providing solutions to daily life challenges such as access to clean water, food and health care, the quality of life of the BoP can be considerably improved (Altman, Rego 2009). The private sector's competitive and formal product offerings can entail elimination of poverty penalties, i.e., higher prices for even basic products compared to the more developed world, which consequently allows the BoP to either have more disposable income remaining or to buy a more satisfactory amount of these necessities (Hammond et al. 2007).

Isolation and dependence of subsistence markets hinders the BoP to develop because "...if the poor can't participate in global markets, they can't benefit from them either" (Hammond, Prahalad 2004, p. 35). The connection with the private sector creates opportunities to bring new technology and break-through findings to the poor. The establishment of telemedicine networks in India between rural villages with hospitals based on satellite technology (Altman, Rego 2009) and a broad range of banking services provided through the use of simple mobile phones in Kenya are examples showing how new technology can benefit the poor and how in some cases the BoP can even leapfrog the developed world (cf. The Economist 2010d). BoP business not only allows for a better satisfying of unmet basic needs at affordable prices, but also offers an inclusive "...opportunity to participate in economically productive activities" (Altman, Rego 2009, p. 47).

Access to information, financial resources, production resources and the formal selling markets can be turned into higher productivity and consequently increase purchasing power (Gradl, Knobloch 2009; London et al. 2010). The E-choupal network in India illustrates the above mentioned positive effects that business can bring to the BoP. Traditionally BoP farmers sell their agricultural goods to local markets where buyers dictate prices and corruption is widespread. Given that isolated BoP farmers do not have any information on current commodity prices, buyers used to take advantage of their vulnerability, paying farmers significantly less than they deserved. However, when the Indian Tobacco Company (ITC) established their network of electronic procurement kiosks called e-choupals based on modern satellite technology and solar power, they directly connected BoP farmers with the soy market. The e-choupals provide important information on current prices, demand

forecasts, weather forecasts, agricultural advice to improve soy quality and potential buyers. Thereby the ITC enjoyed sourcing higher quality soy and better supply chain control and security. The BoP farmers' bargaining power, however, increased and helps to yield better prices and subsequently generate higher incomes. Agricultural advice as well as longer planning horizons help to further improve productivity. Additionally, the network offers opportunities for further economic activities and job creation. Every e-choupal is run by a well-chosen micro-entrepreneur and the kiosks can be used as a platform for other businesses and purposes (Hart, London 2005; Prahalad 2010).

Transactional security and trust such as mentioned in the example of the e-choupal enable the BoP to alter their behavior from day-to-day living to more long-term planning and investments that can further increase productivity and quality of life (London et al. 2010). Inclusive business at the BoP creates new entrepreneurial opportunities and entrepreneurial drive for the poor to actively lift themselves out of poverty (Prahalad, Hart 2002; Hammond, Prahalad 2004).

Beyond satisfaction of basic needs and promotion of inclusive economic activities, business at the BoP increases attention to the once ignored billions of poor people that can serve as basis for further poverty alleviation actions (Hammond et al. 2007). Moreover, processes that treat the BoP in a fair and respectful way contribute to higher levels of self-assurance, confidence and dignity for the BoP (Gradl, Knobloch 2009; Hammond, Prahalad 2004). In terms of Sen's theory of poverty (Sen 2001), the array of new opportunities and choices generated by the private sector eases the deprivations defining poverty.

2.1.2.3 Concerns and concept development

Despite all of the discussed advantages and the potential of the BoP concept for both companies and people living in poverty, it also draws criticism and advice for caution. One important discussion topic centers on the one hand, on the tension between offering choices and opportunities for self-determination to the poor and, on the other hand, protecting the BoP. Karnani (2009) and Davidson (2009) describe the BoP as a very sensitive environment with vulnerable consumers. Their lack of education and experience in evaluating product offerings, promotions and marketing campaigns makes them prone to mispurchases and spending money on goods that do not deliver as expected. Whereas this would annoy wealthier consumers, it would be seriously grave for the BoP who cannot afford to buy another product. Children have, for example, been accepted as being a vulnerable market that is protected accordingly but it remains unclear how to handle the BoP market (Davidson 2009). Uncertainty remains with regard to the product categories sold to the BoP. Should

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