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Profits at the Bottom of the Pyramid

A tool for assessing your opportunities
by Erik Simanis and Duncan Duke



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PROFITS AT THE BOTTOM OF THE PYRAMID

A TOOL FOR ASSESSING YOUR OPPORTUNITIES BY *ERIK SIMANIS AND DUNCAN DUKE*

During the past decade, many multinationals have come up short trying to make a profit by solving the pressing needs of low-income communities. Preoccupied with their social missions, companies have optimistically taken on challenging projects, only to be surprised when weak consumer demand and obstacles such as bad roads

keep revenues low and costs high. Overstretched and disillusioned, many switch gears and reconstitute their ventures as break-even social investments that are destined to remain small.

Profits are critically important for ventures targeting the bottom of the economic pyramid—the more than 4 billion people who individually earn less than \$1,500 per year. Compared with a social responsibility project, a profitable business stands a better chance of being able to increase its scale and impact. It can command resources and be sure of continued support from both the corporate headquarters and the country office.

Profitably selling to the bottom of the pyramid is difficult, but it can be done. It requires companies to focus on business fundamentals and start their ventures with a rigorous understanding of two key challenges in low-income markets: *changing consumers' behavior* and *changing the way products are made and delivered*. Companies that underestimate these hurdles miscalculate the resources, innovation capabilities, and time involved, and project teams end up poorly equipped to accomplish the task.

To help companies ensure that their ventures are built for success, we have developed an “opportunity map”: a framework, drawn from our experience and research in Africa, Asia, and Latin America, that uses these two key challenges to organize bottom-of-the-pyramid opportunities by their cost and complexity. With the map, companies can design and undertake ventures that match their resources and financial expectations—and make profits, too.

Some companies may find that the map warns them away from launching headline-grabbing ventures. That's no reason for disappointment. It's smarter to aim first for smaller-scale, incremental sales opportunities that stand a better chance of success. A steady flow of profits, however modest, will then allow companies to tackle riskier growth opportunities with greater social impact. Putting profits first is the most effective and sustainable way for companies to make a positive impact on the lives of the poor.

The Hurdles in Poor Markets

Let's start by delving into the two main challenges: changing consumers' behavior and rethinking the way products are made and delivered to customers. These are not only the most common hurdles companies face in bottom-of-the-pyramid markets, they're also the most widely underestimated.

Consumer behaviors that have to change.

People resist new products for a variety of reasons, but the biggest is a reluctance to alter deeply ingrained mind-sets and routines. The greater the novelty, the greater the disruption, and people with limited means and limited product experience see extreme novelty in many products.

For example, consumers in sub-Saharan Africa have responded poorly to insecticide-treated bed nets, despite the technology's simplicity and effectiveness in preventing malaria. Companies such as Sumitomo Chemical have had a tough time changing misconceptions about how malaria is transmitted and persuading consumers to hang and take down nets every day (apart from the inconvenience, the nets are hot to sleep under).

Even if a product is familiar, delivery through a new business model might pose an obstacle. Many villagers are used to taking loans from traditional moneylenders, for example, but switching to microfinance represents a big change. In most microfinance models, people must participate in borrowing groups, an activity that takes time and cooperation, and the entire group is responsible for loan repayments.

To successfully educate consumers about new or untried products, companies often have to work with them over sustained periods. Sometimes it's necessary to create consumer groups in order to harness peer pressure and build support for new behaviors. Generating widespread demand can be complex and time-consuming, driving up marketing and sales costs and increasing working-capital requirements.

Company routines that have to change.

Value chains may need to be reconfigured to reach low-income buyers. Customers may require lower price points than the company can meet. They may not have access to the retail outlets where the company sells its products. They may not respond to traditional marketing strategies. Or they may live in rural areas or slums, where business units may be unable to operate at large scale because of poor infrastructure. The more far-reaching the needed changes are, the more complex, time-consuming, and costly they are to manage.

The French eyeglasses company Essilor International provides an example of the challenges posed by the need to significantly alter value chains. The company initiated a pilot program to serve some of India's 6,000 rural villages, using vans set up as

Idea in Brief

THE PROBLEM

Multinational firms' socially beneficial ventures in low-income markets need to earn profits if they're to command corporate resources, but operating in the black is harder than it looks.

THE SOLUTION

Companies can use the authors' "opportunity map" to design and undertake ventures at the bottom of the pyramid that match their capabilities and financial expectations.

THE DETAILS

The map sorts ventures according to cost and complexity by analyzing two key challenges in selling to the poor: changing consumers' behavior and changing the way products are made and delivered. The map can encourage companies to forgo overly ambitious, unsustainable projects and start with smaller ones that generate steady profits.

eye clinics. However, despite efforts to streamline sales operations and outsource production, the company has struggled to generate enough revenue to cover the costs of the vans (\$50,000 each) and offset expenses such as optometrist training. Consequently, Essilor's plans for expanding the program have stalled.

SC Johnson, the household-products company behind such brands as Glade, Windex, Raid, and Ziploc, was among the first corporations to take seriously the long-term strategic potential of selling to the world's poorest people. Having operated in Kenya since the 1960s, it sought to establish a sustainable business that would improve the health and lives of residents in the slums of Nairobi. Working with researchers at Cornell University and elsewhere, the company embraced an exploratory, co-creation approach in order to ensure that its offerings would match consumer needs. (Disclosure: We were involved in the project during its first three years, starting in 2005.)

Research revealed that consumers wanted to rid their homes of insects and sanitize pit latrines. This led SC Johnson to form a home-cleaning service that used several company products, including cleaners, insecticides, and air fresheners. Sales and labor were performed by youth groups that were already providing trash collection services. However, consumers were so accustomed to their surroundings that the offer of a "clean and healthy home" didn't resonate, and local norms were a deterrent to inviting strangers inside.

Undaunted, the team switched to providing a service cleaning toilets in schools, housing developments, and other facilities. But recruiting workers from the slums and training them to consistently do a high-quality job proved costly and time-consuming. There were complications importing SC Johnson's products in bulk and establishing

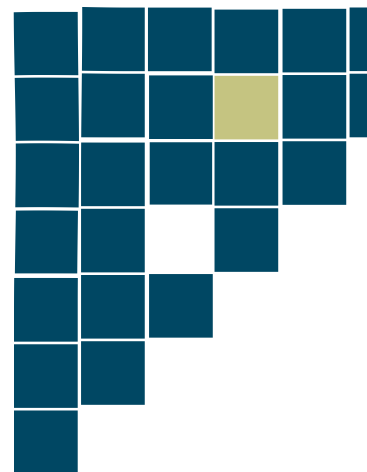
a franchise agreement with the local business unit. Moreover, the company was in the process of converting its Kenya office into a lean sales outpost, which didn't match the venture's long investment time line and resource needs.

Although the cleaning business acquired a number of customers and delivered on its service promise, it did not meet its financial objectives and could not be considered a viable business investment for the company. SC Johnson ended its financial support of the effort and helped it transition into an independent nonprofit.

The lessons learned in Nairobi proved valuable when SC Johnson went on to another bottom-of-the-pyramid venture: promoting the use of insect-control products in rural Ghana, with the goal of helping prevent malaria. The company recognized two main challenges: Consumers didn't understand malaria's cause, and the villages lacked distribution channels.

In response, SC Johnson created a direct-sales model with coaches providing hands-on product demonstrations in homes and at gathering places in the community, thus building social support. Insect-control products were bundled with other items that consumers valued, such as air fresheners, which made sales more likely. In addition, buyers were given refillable containers, which reduced packaging costs. And subscription pricing, together with loyalty rewards, ensured that customers used products multiple times, thereby becoming more comfortable with the new product routines.

Changing consumers' behavior and rethinking the way products are made and delivered are the most common hurdles companies face in bottom-of-the-pyramid markets.



Creating this high-touch channel, and selling products in a refillable format, required new capabilities. Designers and R&D personnel worked closely with the business unit on the ground to ensure that product formulations and formats met margin requirements. The team also considered such matters as how salespeople would dispense products. The project had a strict time line for assessing proof of concept, and the field team was given a clear payback schedule in order to track the business’s performance. (See “Reality Check at the Bottom of the Pyramid,” HBR June 2012.) Because of all this groundwork, the Ghanaian project has so far been largely free of the tribulations that plagued the Kenyan initiative, and the pilot has made promising strides.

The Opportunity Map

Lessons learned by SC Johnson and other companies helped us create our opportunity map. We’ve parsed business prospects at the bottom of the pyramid into nine types (see the exhibit “Nine Kinds of Opportunities”). Below we outline a typical scenario and present an example for each, starting with the

least complex and resource-consuming and ending with the most.

Targeted market-ing opportunity.

Because of a knowledge gap, consumers are underutilizing a product that can be bought through traditional retail channels. The goal is to boost short-term consumption of that product

while strengthening the company’s brand in an up-and-coming mass-market demographic.

Dialog, Sri Lanka’s largest provider of telecommunications services, had low sales among the rural poor, despite the fact that its mobile phones and telephone cards were readily accessible through a network of 40,000 small-scale retailers. Village dwellers couldn’t relate to the always-connected lifestyle these products made possible, and they were unaware of the full range of mobile services the company offered. To increase penetration, Dialog created a network of trained women “infomediaries” who coach villagers in the use of mobile phones and help them gain the confidence and capacity to take advantage of Dialog’s services.

Product redesign. Although bottom-of-the-pyramid consumers are buying a version of the product through the same channels as mainstream customers, the company could enhance the product to meet additional needs and boost the overall value proposition. The goal is to capture greater market share with a category-leading product.

In 2011, after market research revealed that poor adolescent girls in India often suffer from iron deficiency, PepsiCo worked closely with consumers in two districts in Andhra Pradesh to create a line of iron-fortified cookies and snack puffs under the brand Lehar Iron Chusti (Lehar Iron Health). To appeal to the wide variety of palates across the country, Pepsi began releasing a new flavor every month.

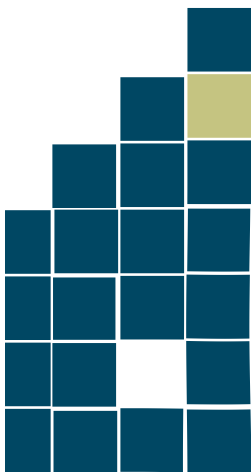
Distribution extension. Bottom-of-the-pyramid urban consumers with access to a company’s sales channels are buying its product in an existing format, but those who live beyond the company’s reach in peri-urban areas and larger market towns might also value the product. There is some modern infrastructure in the targeted areas, and a few businesses and government organizations are operating at scale. The objective is to harness existing nontraditional channels that can quickly and easily reach consumers.

In parts of rural India, Bajaj Allianz General Insurance has partnered with SKS, India’s largest microfinance institution, to approach the husbands of SKS’s female customers and sell them a life insurance policy that also functions as a savings instrument. In the first 10 months of 2009, Bajaj sold 1.8 million policies, generating premium income of \$33 million.

New channel creation. A large rural population living beyond the reach of a company’s sales outlets may be using products that provide the same core functionality as the company’s offering. The objective is to build, from the ground up, a parallel distribution and sales channel that can penetrate hard-to-reach rural areas.

The Danish-owned West African dairy company Fan Milk established a street-vendor model to make its frozen dairy and juice products available in rural areas where there are no cold-storage facilities. Vendors purchase Fan Milk bicycles and pay for products before they sell them. The company provides product training and free bike repair services. Fan Milk supports approximately 25,000 vendors in West African countries, including Ghana, Ivory Coast, Nigeria, and Burkina Faso.

The objective of new channel creation is to establish a parallel means of distribution, such as Fan Milk’s bike-riding vendors in West Africa.



New product development. A company sees an unmet need that dovetails with its product-development capabilities. Consumers are using low-quality substitutes that lack key functionality or don't stand up to challenging environmental conditions. The goal is to establish a competitive advantage in a mass-market category by designing and engineering a product to be affordable and robust.

In 2009 Godrej Appliances launched the Chotukool, a revolutionary portable refrigerator for the rural Indian market, where a third of all food is lost to spoilage. By using a solid-state cooling chip and eliminating the compressor, the company reduced power requirements to a mere 62 watts and cut the price for an entry-level refrigerator in half, to just \$69. The product runs on a battery, weighs less than 10 pounds, and keeps food fresh and cool at temperatures between 40 and 60 degrees Fahrenheit. Today multiple versions of the Chotukool are produced and sold through retail channels reaching consumers across socioeconomic levels.

Conquest of competitors' market. A growing industry made up of small and medium-size enterprises is serving poor consumers in an area where the company has no operations, and in order to be competitive, the company's product requires only minor modifications. The strategic objective is to use the company's economies of scale to outstrip local competitors and capture significant market share, thereby establishing a platform from which to expand to other markets.

Grupo Bimbo, the world's largest baked-goods company, expanded from its home base in Mexico to China, Brazil, and other South American countries in the early 2000s, mainly by acquiring local bakeries. As it adapted its products and brands to each market, it sought to make use of its investments in operational and distributional capabilities. While its Mexican plants are among the largest and most flexible in the industry, it has often had to upgrade the facilities acquired abroad in order to meet its standards. In China, operational changes improved productivity on some lines by 300%.

Greenfield-market expansion. The company already serves bottom-of-the-pyramid consumers in one area, but it could tailor its core offering and business model to meet the needs of similar consumers in a different area. The goal is to use the firm's operational skills to establish a market-leading position in a region of long-term interest.

When BRAC, a world leader in social and economic development, expanded from its home base in Bangladesh to East Africa, it replicated some signature innovations, such as creating large-scale microfinance programs and training promising women participants as community health entrepreneurs. In Uganda and Tanzania, BRAC's Essential Health Care program has been adapted to address the health priorities of the region, including malaria and HIV/AIDS. BRAC has since grown to become the largest development organization in Uganda, as well as one of its largest microfinance institutions.

New business-model development. The company believes the core functionality of its current product would be valued by a large rural consumer market; consumers may be using substitutes that are costly and inefficient. The company's current product, however, is priced beyond their means, even with extensive cost cutting. Furthermore, the company's business model requires infrastructure that is absent in the targeted area. The strategic goal is to establish first-mover advantage in a large, latent market by scouting and securing choice assets and limited partnerships.

Hindustan Unilever took a decade to incubate its first consumer durables, the Pureit family of water purifiers—innovative gravity-fed, tabletop devices guaranteed to kill germs. Targeting both low- and middle-income Indian customers, HUL developed four new routes to market, including an outsourced “demonstration workforce” of 10,000 people to pioneer its direct-to-home distribution and customer-education channel. After launching the Pureit brand nationally, in 2008, HUL sold more than a million units in the first year.

New market creation. The company believes there's an unmet need among a large population of low-income consumers living in hard-to-reach rural areas. There are no substitutes in the market, and consumers are largely unaware of the need for the product. The strategic objective is to nurture the creation of a new market intimately tied to the firm, placing the company's brand in a powerful position. SC Johnson's Ghana venture is a good example of this opportunity type.

A Multipronged Approach

Several of these opportunities often present themselves simultaneously. Smart companies take a portfolio approach, following up on each according to its manageability and potential for return.

Nine Kinds of Opportunities

The nine opportunity types fall into three main investment classes: mature markets, growth markets, and frontier markets, shown in different shades below. As you move away from the bottom left corner, the opportunities become increasingly complex and resource-intensive, because they require more consumer learning and value-chain modification. New market creation is the most challenging opportunity of all.



That's the case with the French industrial giant Lafarge, the world's largest cement manufacturer. The company's long-standing commitment to sustainable economic development and to meeting the developing world's burgeoning housing needs led it to create a dedicated affordable-housing team based at its Paris headquarters. The team works closely with local offices in target countries to pilot-test ventures that complement local strategic priorities and address broader innovation objectives.

One of the company's ventures—a mature-market opportunity—is aimed at strengthening Lafarge's competitive position in retail stores, where it sells most of its bagged cement and competes aggressively for shelf space. In an effort piloted in Indonesia and Nigeria, Lafarge links retailers with microfinance organizations so that the stores can offer home-improvement loans and construction support to low-income consumers. Lafarge's primary investment is in a team of home-improvement “counselors” who market the service through channels such as information kiosks set up in stores. The counselors also connect customers to architects and other experts, provide advice on building materials, and ensure that borrowed funds are actually used for building.

In India, Lafarge is pursuing a growth-market opportunity involving the creation of a new sales and distribution channel. This venture aims to bring 15-liter bags of high-quality, ready-mixed concrete to the doorsteps of slum residents seeking to build homes. To overcome consumers' resistance to paying for the transportation and mixing of the concrete, which they could take care of themselves, Lafarge focuses on saving consumers time and reducing wasted concrete, which help them save money. The company pledges to deliver the product within 50 minutes of the time an order is called in. To meet the value-chain challenges, Lafarge has designed mini-plants that can be located near slums. Its product developers have also redesigned the product formulation and packaging so that the bags of concrete can withstand transportation in three-wheelers. This combination of strategic features presents a formidable entry barrier for competitors.

A third project for Lafarge is a greenfield-market expansion. Although the low-income consumers this venture targets live in wealthy, industrialized countries, it is every bit a frontier-market investment. It aims to drive sales by selling to developers an affordable-housing solution designed for the

hard-to-build-on plots of land that represent the majority of unbuilt space in established city centers. The company has created a demonstration project in a municipality in southwestern France: a multistory concrete shell in which homes, gardens, and green spaces are attractively nested on every level. By tackling a high-profile political issue (affordable housing), the venture overcame one of the project's value-chain challenges—namely, spurring interest and awareness among municipalities and developers. Given the long time line and uncertain cash flow, project oversight extends to the company's CEO.

BOTTOM-OF-THE-PYRAMID OPPORTUNITIES come in a variety of shapes and sizes, but successes demonstrate a recurrent lesson: the value of focusing on profits. Blinded by devotion to social missions, too many companies with grand ambitions overlook profitable opportunities that match their resources and skills and jump into ventures that overwhelm their capabilities. A more realistic assessment of the challenges at the bottom of the pyramid can help companies generate the profits that will make socially beneficial businesses sustainable over the long term. ♥

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