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To succeed in the world's poorest markets, aim for much higher margins and prices than you thought were necessary—or possible. ***by Erik Simanis***

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Erik Simanis is the managing director of Market Creation Strategies at the Center for Sustainable Enterprise at Cornell University's Johnson School of Management.

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ABOVE MightyLight customers in Barmer, Rajasthan, India

PHOTOGRAPHY: COURTESY OF MIGHTYLIGHT

Most companies trying to do business with the 4 billion people who make up the world's poor follow a formula long touted by bottom-of-the-pyramid experts: Offer products at extremely low prices and margins, and hope to generate decent profits by selling enormous quantities of them. This "low price, low margin, high volume" model has held sway for more than a decade, largely on the basis of Hindustan Unilever's success in selling Wheel brand detergent to low-income consumers in India.

However, as an abundance of recent experience shows, the model has a fatal flaw: It inevitably requires an impractical penetration rate of the target market—often 30% or more of all consumers in an area.

Stories of well-meaning commercial ventures that couldn't make sustainable profits are all too common in low-income markets. Despite achieving healthy penetration rates of 5% to 10% in four test markets, for instance, Procter & Gamble couldn't generate a competitive return on its Pur water-purification powder after launching the product on a large scale in 2001. Although the price—equivalent to 10 U.S. cents a sachet—provided a margin of about 50%, on par with that of the company's products worldwide, P&G gave up on Pur as a business in 2005 and announced that the sachets would be sold only to humanitarian organizations at cost.

DuPont ran into similar problems with a venture piloted from 2006 to 2008 in Andhra Pradesh, India, by its subsidiary Solae, a global manufacturer of soy protein (disclosure: I was the venture's initial field lead and afterward stayed on as a consultant). Intended to alleviate malnutrition and open a new market for the company, the venture aimed to get mothers in rural areas and urban slums to cook with soy protein as part of their daily routine. The product mix consisted of small packets of protein isolate, which provided about half of woman's average daily protein needs, and a range of packaged, soy-fortified snack foods all priced below 30 U.S. cents. The isolate's margins were on a level with those of Solae's core business-to-business products, but sales proved to be inconsistent. Sales were stronger for the snack foods, but the margins were significantly lower—so low, in fact, that the company would have had to sell quantities much higher than could have been absorbed by the communities within reach of the business. Unable to see a path to profitability, Solae closed the pilot.

As these and other ventures suggest, cost structures in low-income markets are daunting: Operational expenses, such as distribution, are frequently much higher than those that companies face in developed markets. In addition, customer acquisition and retention for new products often demand unusually intense—and costly—levels of high-touch engagement. To cover those high costs, much greater volumes are needed for break-even.

However, selling to customers in rural villages and in slums scattered across urban centers is difficult and inefficient. Each local business unit is forced to generate its sales volumes from the consumer base living in a narrow geographical range—often just a small cluster of villages in rural areas, or several neighborhoods in the case of larger slums.

Any business that starts off needing a 30% or higher penetration rate is built on a shaky foundation. At the bottom of the pyramid, it's a losing proposition. Instead, companies seeking to improve the lives of the world's poor should focus on a more realistic route to profitability: They need to elevate gross margins far above the company average by pushing down variable costs and boosting the price consumers are willing to pay for a unit of product. They also need to raise the price point for a single transaction. This combination of higher margins and higher price points increases the contribution—the amount of money that goes to covering fixed and operating costs—generated from every transaction.

That's a tall order. But my experience leading businesses in Africa, India, and other emerging economies shows that it can be done. In this article, I will show how to build a margin-boosting platform that can help companies solve the cost problems inherent in bringing needed products and services to very poor markets. A few companies are already using aspects of a platform to improve their profitability prospects, and S.C. Johnson, the household-products maker, has launched an integrated margin-boosting platform for selling insecticide in rural Ghana as part of an effort to reduce malaria infection there. Initial results for that venture show the financials moving in the right direction.

Why Low Prices and Margins Don't Work

C.K. Prahalad was a leader in focusing corporate attention on business opportunities among consumers at the bottom of the economic pyramid. His view that very-low-income markets are best reached through the low-price, low-margin, high-volume model has cast a long shadow on corporate strategy in these markets. And, indeed, the model works well if two conditions are met: One, the company can leverage an existing infrastructure that serves wealthier customers to offer a product or service to poor consumers; and two, the consumers already know how to buy and use the offering.

Unilever's Wheel detergent benefited from those conditions in India. The company's well-established distribution and retail channels, which served middle-class consumers in accessible cities and surrounding areas, were used to serve low-income consumers. Because Wheel was sold alongside the company's other products in the small *kirana* (grocery) shops frequented by both middle-class and poor consumers, the revenues from the poorest consumers needed to cover only the incremental costs of the new product. Furthermore, detergents weren't new to customers, so Unilever didn't have to spend money creating demand from scratch and educating customers about how to use the product. Thanks to the existing distribution network and consumers' familiarity with the product category, Unilever could afford to sell Wheel for 30% less than its other detergents.

Both conditions also held in the case of Manila Water in the Philippines, a well-known example of success in a bottom-of-the-pyramid market. The company's pipes and central metering points provided water to 6 million mainstream customers in Metro Manila's east service zone. In the late 1990s, an additional 2 million low-income people living in and around the city were added to the customer base, with relatively small incremental investments.

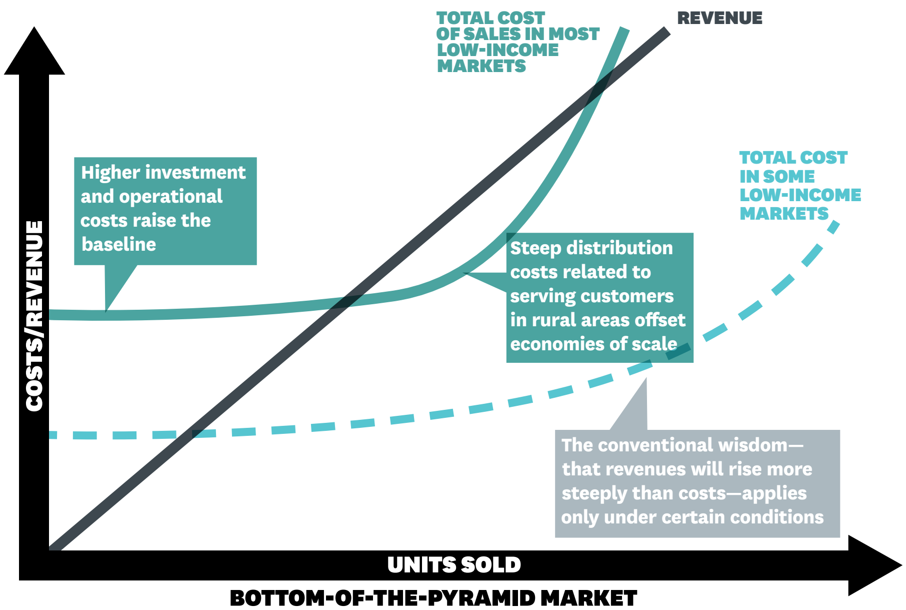
The problem with this model is that opportunities to leverage existing infrastructure are usually limited, and most products sold by bottom-of-the-pyramid ventures are new to the target consumers. In fact, after a 2009 review of more than 270 market-based ventures aimed at alleviating poverty, Monitor Group reported that it had found only a "handful" that were able to operate on a scale large enough to be commercially viable. Even Unilever has been unable to reproduce Wheel's financial success with Project Shakti, a venture it launched in 2000 in rural India, where the company had no infrastructure.

The reality is that most bottom-of-the-pyramid ventures stumble over the dual obstacles of village scale and high-touch sales.

Village scale is optimal but capital intensive. In emerging markets' rural areas and shantytowns, roads are usually narrow, unlit, unpaved, and heavily potholed,

The Volume Game: A Losing Proposition

Experience in most bottom-of-the-pyramid markets contradicts the conventional wisdom that very-low-priced consumer products can be profitable at high volumes.



and the high cost of local transportation traps consumers where they live. If a company tries to expand beyond a village or a small cluster of villages, marginal costs rise rapidly and efficiency drops. Solae, for instance, tried to expand from its original group of target villages to more-distant areas, but travel time cut significantly into selling time and pushed up costs. The incremental sales couldn't be justified.

Numerous ventures in low-income areas operate at a village scale. Take ITC's e-Choupal initiative, which provides rural Indian farmers with online market and agricultural data. Each internet kiosk serves farmers living within just a five-kilometer range. Or consider Danish multinational Grundfos's clean-water-dispensing system. Each LifeLink serves just a single village.

Capital expenditures associated with a distributed business model are invariably higher per unit of output. Each local operation needs warehouse space, production and office equipment, a security guard, utilities, and so on. Moreover, every replication of the business requires a full organizational team, and recruitment and development of these employees is expensive and time-consuming.

High-touch sales and marketing are costly. Consumers at the bottom of the pyramid lack what anthropologists call a "cultural competence" for product consumption—they aren't accustomed to using and experimenting with products. The adoption of new products entails a steep learning curve for them. Consequently, sales and marketing efforts involve deploying a substantial number of people with sales skills and deep product knowledge—an expensive proposition. Finding talent is an even bigger challenge in low-income areas, where illiteracy and innumeracy are rampant.

During the mid-2000s, for example, Sri Lankan telecom provider Dialog had to create a high-touch business model built around village-based women "infomediaries"—entrepreneurs who functioned as coaches—because without them, adoption was very low.

Operating at a village scale and using a high-touch sales process also mean slower growth. Delayed cash flows can take a big bite out of the net present value of an investment. That's a problem for bottom-of-the-pyramid investments, because discount rates for risky projects in emerging markets can top 30%.

Margin-Boosting Solutions

To cover the higher costs of operating in low-income markets and to work around the restrictions of slower growth and limited volumes, companies need to generate a high contribution from every sales transaction. That requires a three-pronged margin-boosting approach: localized base products sold as a bundle, an enabling service, and customer peer groups.

Localize and bundle base products. A localized base product is an offering whose final processing prior to sale—such as dilution or combination with other components or ingredients—is done as close to the target market as possible. The company saves on labor costs because local wage rates are low. Solae was able to double gross margins by getting repeat customers to use their own refillable containers when they bought bulk protein (but it wasn't enough to save the venture).

Bundles save consumers time and money in gaining access to needed products and create a richer consumer experience whose total value is greater than the sum of the parts. At the same time, bundles allow companies to sell more per transaction. For instance, a low-income consumer can more easily lay out the money for a "body care kit" that contains several needed products such as shampoo, toothpaste, and other products than pay the same amount for a single product, like a large-size shampoo.

Makers of solar-powered lights—for example, D.Light and Duron—provide both light and other needed functionality, such as a capacity for recharging cell phones, in their products. Cosmos Ignite's MightyLight integrates a portable radio, and the company is considering adding more functionality, such as the ability to run battery-operated devices and water purifiers.

Offer an enabling service. To sustain high margins, it is also necessary to offer a service that engages customers and gives them the knowledge and skills needed to maximize products' functionality. A close relationship between consumers and service providers also adds intangible value to the consumer experience, allowing companies to charge a premium.

For example, for about $14 a week, Mexico-based cement manufacturer CEMEX sells low-income families a service that helps them build their own homes more effectively and at lower cost by providing access to inspections, warehousing of materials, and the advice of an architect. The price includes the company's cement products.

Cultivate customer peer groups. Like a sewing circle or an investment club, a customer peer group is a close-knit association of people who share an identity—but in this case, it's built around a product. Such groups extend the high-touch benefits of an enabling service, as members help one another adopt new behaviors and mind-sets that make the product more beneficial.

Peer groups also drive up the size of sales transactions: A single sale aggregates the demand of many customers. Grameen Bank, the microfinance bank in Bangladesh, is well known for its use of peer groups: Self-formed clubs of five to 10 people, usually women, share responsibility for microloans. A group will typically give itself a name and meet regularly to check on members' businesses. Grameen boosts the loan amounts given out per transaction by interacting with the lending circle, not individual borrowers. It attributes its 99% repayment rate in large part to the self-imposed discipline and mutual learning induced by the peer-group approach.

Margin-Boosting Platforms

Achieving sustainable margins in low-income markets requires integrating three common approaches—localizing and bundling products, offering an enabling service, and cultivating customer peer groups—into a coherent strategy.

Enabling services engage customers and give them the knowledge and skills needed to get the most out of products.

Aiming to Reduce Malaria in Rural Ghana

While Solae, CEMEX, and Grameen have seen the value of using individual aspects of the margin-boosting platform, a new project in Ghana by the global consumer products company S.C. Johnson—a leader in household cleaning, pest control, and air care products—has implemented a platform with all its parts. At the time of this writing, the project, which I am working on in partnership with Cornell University, S.C. Johnson, and the Bill & Melinda Gates Foundation, was three months into a 15-month pilot. The early results are promising. Here's a snapshot of the business.

The goal: To reduce rates of malaria infection by getting low-income consumers to use S.C. Johnson's mosquito control products as part of their daily routines. The project is part of the company's broader social mission to develop consumer-level, market-based solutions to endemic health problems among at-risk populations. These solutions are meant to complement traditional philanthropic and aid-based efforts.

The market: The pilot's target market consists of rural villagers, mostly subsistence farmers. Daily spending by these families ranges from $1.50 to $5. None of

BUNDLED PRODUCTS

Packaging several product functions together provides a richer experience for customers and improves their access to needed products—and at the same time allows companies to sell more per transaction. For instance, MightyLights' solar-powered lights often provide other functions such as phone recharging.

ENABLING SERVICES

Services can increase the value of a product set for consumers. By providing architectural and other services with the sale of cement, CEMEX helps Mexican consumers build better homes with its products while boosting the gross margin per transaction.

CUSTOMER PEER GROUPS

Associations of customers provide additional value and help aggregate sales, thereby reducing costs. Grameen Bank's peer groups in Bangladesh help members learn about financing and encourage timely repayment of microloans.

PHOTOGRAPHY: LEFT COURTESY OF MIGHTYLIGHT; MIDDLE: ARCHIVO PARTICULAR/NEWSCOM; RIGHT: PHILIPPE LISSAC/GODONG/NEWSCOM

S.C. Johnson's product lines, including pest control, are part of these consumers' daily routines.

The numbers challenge: The costs of the village-scale, high-touch model were expected to be high. Key variables included the number of salespeople needed to service the area effectively, depreciation costs for motorbikes used by salespeople on rugged roads, and marketing expenses required to educate and support rural consumers. Market-penetration rates were expected to be relatively low because of the novel nature of the offering and the limited customer load that each salesperson could support. Initial projections revealed the need for a price point that was well above the discretionary income of the target group, at a gross margin far higher than what the company required from traditional markets.

The solution: The team worked backward from the numbers to craft a business concept that would yield a contribution per transaction necessary for profitability—a critical component for any sustainable business solution. The resulting offering—a membership club for homemakers called Wow—integrates the three key elements essential to boosting gross margins and price points at the bottom of the pyramid.

Homemaker gift basket: Club members receive a home care "gift basket" containing four S.C. Johnson products, including mosquito control products, in bulk format. The company provides each club chapter with branded, reusable containers for periodic refilling.

A homemakers' club: Membership is offered as a service that enables customers to care for their homes and families more effectively. It turns the job of home care into a social experience by connecting homemakers in a variety of ways. Members take part in coaching sessions that are designed to be fun and interactive, covering topics ranging from malaria prevention to home-cleaning best practices. Club members talk about their own experiences and share solutions to everyday problems. A homemaker-of-the-year contest and mini-festivals bring together member groups from neighboring villages to eat, dance, socialize, build connections, and celebrate one another's experiences. These connections have long been a valued part of Ghanaian culture. For every three consecutive months of membership, participants earn loyalty rewards made up of common products valued by farming families.

Local chapters: Memberships are sold not to individuals but to small groups of homemakers that come together to form a chapter. Each chapter pays a monthly fee on behalf of all its members.

Results: To date, results are trending in the right direction. In each of the first three months of the pilot, sales have outpaced projections, and costs have been consistent with initial estimates. The sales numbers indicate successful consumer adoption of Wow products that help prevent malaria.

Next steps: If results remain strong, the next step would be to replicate the business model rapidly enough to pay back the initial investment and to further the project's social mission. Given the importance of soft skills to the sales team's effectiveness, making the recruitment and training process more standardized (and therefore replicable) will be a focal point.

IF COMPANIES WISH to launch flourishing ventures capable of transforming the lives of millions of low-income people across the developing world, they must get back to basic business tenets. However laudable its mission, a business built on unrealistic expectations will fail just as surely at the bottom of the pyramid as in a developed market.

Because the high costs of doing business among the very poor demand a high contribution per transaction, companies must embrace the reality that high margins and price points aren't just a top-of-the-pyramid phenomenon; they're also a necessity for ensuring sustainable businesses at the bottom of the pyramid.

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