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Cross the invisible line into the base of the economic pyramid in emerging markets and you enter a world of pitfalls. If a company embarks on an initiative that focuses solely on commercial gain, civil society and governments are likely to oppose it intensely, as the international water utility company Aguas del Tunari discovered in Bolivia. If a company tries to stay under the radar by keeping its base-of-the-pyramid operations small, profits are likely to be meager, as Procter & Gamble found out with its water-purification product in Latin America and Asia. Even if you focus mainly on social impact and consider profits secondary, the base of the pyramid is a risky place: Projects that fail to make money will eventually be relegated to companies' corporate social

responsibility departments, as Microsoft discovered.

Our research has shown a way to traverse this difficult landscape. Indeed, decent profits can be made at the base of the pyramid if companies link their own financial success with that of their constituencies. In other words, as companies make money, the communities in which they operate must benefit by, for example, acquiring basic services or growing more affluent. This leads to more income and consumption—and triggers more demand within the communities, which in turn allows the companies' businesses to keep growing. A corollary of that principle is that from the very beginning, scale is critical: Tentative forays into the base of the pyramid do not yield success.

Which Value-Creation Strategies Work Best at the Base of the Pyramid?

LOW INCOME
\$3–\$5 A DAY
1.4 BILLION PEOPLE

SUBSISTENCE
\$1–\$3 A DAY
1.6 BILLION PEOPLE

EXTREME POVERTY
BELOW \$1 A DAY
1 BILLION PEOPLE

All four of these strategies can be applied throughout the base of the pyramid, but each has a sweet spot in one of the income segments.

1

Providing appropriate and affordable products and services directly to consumers

Sweet spot:
LOW INCOME

2

Enlisting individuals or small businesses to provide efficient reach and coverage

Sweet spot:
SUBSISTENCE

3

Engaging the community to coproduce value—for example, in the supply chain

Sweet spot:
SUBSISTENCE

4

Forming commercial partnerships with governments and NGOs

Sweet spot:
EXTREME POVERTY

Business models that call for creating private and public value while aiming for scale are gradually becoming more prevalent. Hindustan Unilever has succeeded by training tens of thousands of sales and distribution agents. The Afghan mobile network operator Roshan has succeeded by doing the same for small retailers. The local communities' growing economic health boosts profits and prosperity for everyone along the value chain.

In studying dozens of companies over many years, we have found that those with skill at simultaneously building private and public value tend to have a nuanced understanding of their constituencies. The 4 billion people at the base of the pyramid—whose output represents one-third of the world's economy—are not a monolith. To emulate the most effective pioneers, companies must commit to learning what constitutes value for the various components of this population. The way to start is to divide the 4 billion people into three basic segments.

Segmenting by Living Standard

The simplest way to analyze the base of the pyramid is to recognize that the income level of \$1 a day separates the extremely poor from everyone else, and that people above that demarcation can be roughly divided into those earning \$1 to \$3 a day and those earning \$3 to \$5 a day. It's not the only way to categorize this tier of the pyramid, but it's a useful one.

Low income. The adults among the roughly 1.4 billion people who live on \$3 to \$5 a day typically have a couple of years of

secondary education and the skills needed to enter the job market. Many earn semi-regular incomes as construction workers, petty traders, drivers, or low-level staff in public and commercial establishments. They conduct their transactions in both formal and informal markets, and they tend to live near or among the people who occupy the next layer up in the pyramid—those with incomes of just over \$5 a day. Families in the \$3 to \$5 segment often own such consumer goods as bicycles, televisions, and cell phones. As they strive for higher education and steadier, better-paying work, they need good housing and access to credit and to health care specialists. Many of them have a reasonable hope that they or their children will achieve a modestly higher living standard.

Subsistence. The bulk of the roughly 1.6 billion people who live on \$1 to \$3 a day are poorly educated and low skilled. Although they typically have some income as day laborers or temporary workers, their earnings are not steady. Many need improved sanitation, health care, and education. They can typically afford one square meal a day, but the nutritional content is often substandard. If they live in slums or shantytowns, they might work as helpers or assistants in petty trade. In rural areas, they are likely to be temporary, migratory farmhands during sowing or harvesting seasons. As both consumers and producers, they conduct transactions in informal markets, which often bustle with activity but are inefficient because they lack infrastructure and supportive institutions. Without bank accounts or access to formal

credit, they turn to moneylenders for loans at exorbitant rates and are vulnerable to exploitation by middlemen. Unlikely to reach a \$5-a-day standard of living, they nonetheless strive to improve their circumstances. They need gainful employment and inexpensive items for day-to-day living.

Extreme poverty. The bottom 1 billion lack basic necessities: sufficient food, clean water, and adequate shelter. War, civil strife, and natural disasters have displaced many from their homes. They are forced into transactions that are irregular even by the standards of informal markets. Some live in barter economies; others are bonded laborers. Women often have to walk long distances along nonsecure pathways to fetch water. Poor health, lack of nutrition, financial vulnerability, limited education, and a dearth of marketable skills shut them out of the organized economy. The precariousness of their daily existence precludes participation in the market as consumers or producers. The lucky ones receive aid from nonprofit and international agencies or government relief programs.

Segmenting by Value-Creation Role

In addition to segmenting the people at the base of the pyramid by standard of living, businesses need to understand the roles those people can play in the value-creation relationship: as consumers, coproducers, or clients.

Consumers. Companies can provide value to consumers by directly addressing their needs for services such as clean water, better sanitation, education, and credit. A

more indirect way is to introduce innovations that enable people to devote fewer resources to basic activities and more to other pursuits. If all their costs and hours are fully taken into account, people at the base of the pyramid often turn out to be paying premiums for, and wasting a great deal of time on, products and services that are shoddy at best. So there's significant room for innovative businesses to provide good-quality offerings with lower overall usage costs and greater convenience than those of present alternatives. The result: a profound effect on productivity.

Before 1997, for example, many people in eastern Manila, in the Philippines, were not connected to the water system and were paying six times the municipal rates to buy low-quality water from informal dealers. Delivery costs drove the high prices: The municipal system was being tapped illegally, and the water was transferred to trucks, passed to intermediaries, and sold door-to-door in jerry cans, leaving it vulnerable to contamination. Manila Water, a private consortium, found ways to connect more people to the city system, reduce the trade in pilfered water, and bring costs down for millions of people. The company benefits economically from the increased volumes being used, but it also has created public value by improving people's access to clean, less expensive water.

Casting the people in the role of consumers is often most appropriate in the low-income segment, where individuals have the greatest resources for making purchases and a business can shape a profitable value proposition on the demand side alone. People in the subsistence segment also have consumer potential, but considerably less of it. (See the exhibit "Which Value-Creation Strategies Work Best at the Base of the Pyramid?")

Coproducers. When a company views base-of-the-pyramid residents as coproducers, it provides them with work and income. A multinational might, for instance, give farmers technical knowledge to upgrade the quality of their output and reward them with greater monetary returns,

as Nestlé has done with the sourcing of milk from small dairy farmers in Asia and Mars has done with cocoa farmers in West Africa. With a little training, people at the base of the pyramid can also take part in basic production and assembly jobs or in activities such as transportation, distribution, and retailing—bridging the "last mile" to the customer. For example, Hindustan Unilever has helped to create entrepreneurs by training 50,000 women to go door-to-door educating consumers and selling soap, toothpaste, and other products. These women in turn nourish the local economic ecosystem by borrowing from local banks and microfinance institutions.

Companies may find that engaging people as coproducers is most appropriate in the subsistence segment because earning some additional income is their primary

Companies too often assume that their responsibilities end once they have provided a needed product or service.

need. With this extra income, they can try to improve the quality of their consumption. However, businesses also can and do engage people in the low-income segment as coproducers—for example, by employing them to make products for consumers who are higher up in the pyramid. Individuals in the extreme-poverty segment are not potential coproducers because they are too difficult to access or don't have the necessary skills.

Clients. A significant portion of the people at the base of the pyramid, primarily in the extreme-poverty segment, are most appropriately treated as clients. The reality is that they need "agents," so to speak, to garner resources on their behalf. The government can serve as an agent, as can a civil society institution, a community organization, or a commercial enterprise. For example, Devi Shetty's advocacy for farmers and other workers in Karnataka, India, engendered the Yeshasvini Health Insurance plan, which started with government sub-

sidies. Patients covered by Yeshasvini are eligible for free care, but bureaucracy and poor management in the public health system too often prevent people from getting acceptable levels of service. The insurer became an advocate for the poor, negotiating for better service from public hospitals. Those hospitals also benefited, by receiving payments from Yeshasvini.

Missteps at the Base of the Pyramid

Numerous companies have blundered by failing to understand the importance of bolstering the success of the base-of-the-pyramid communities where they do business. Too often they assume that their responsibilities end once they have provided a needed product or service, or have engaged people as suppliers or workers.

That attitude leaves companies vulnerable to criticism. In 2000, when the Bechtel-led water consortium Aguas del Tunari tried to raise water tariffs and collect rents on private wells in Bolivia, all within the purview of its privatization agreement with the local government, violent protests erupted, forcing the company to abandon its business. In essence, it had failed to recognize how people in the region defined success for themselves and, therefore, failed to contribute to that success.

The same trap has ensnared microfinance. The industry is periodically threatened with shutdowns, especially in India, because of outcries over interest rates, even though the average rate charged by Indian microfinance institutions is among the lowest in the world: 25% to 27%. The real problem is that microfinanciers have sometimes appeared to be profiting on the backs of the poor, less because of their interest rates than because of policies that ignore social value. Many microfinance firms assume

Where Private and Public Value Intersect

The Opportunity

Two decades ago, many of the poor in eastern Manila, the Philippines, were paying six times the municipal rates to buy their water in metal jerry cans from vendors who had illegally tapped into the water system.

The Execution

In 1997 Manila Water, a private consortium, won the concession for providing water. It improved access to clean, less-expensive water and gained consumers' trust by partnering with public authorities, local communities, and contractors. Exclusivity rights and other government guarantees gave the company an incentive to rapidly build infrastructure, if it met certain thresholds for service in poor communities. Manila Water has managed to invest more than \$1 billion in capital improvements and to install several thousand miles of its distinctive blue PVC pipes.

The Results

A GREATER THAN 15% RETURN ON EQUITY EACH YEAR FOR THE PAST 10 YEARS



they are doing the poor a service just by offering lower rates than moneylenders do. They appear not to recognize that many of their clients, despite getting loans, have been unable to achieve a higher standard of living. As a result, the companies become scapegoats when customers face tough economic times.

Equitas is one Indian microfinancier that hasn't been targeted. It has shown a commitment to social value by earmarking 5% of its profits for clients' health care, skills development, and children's education, and it has placed a cap on its profits.

In many instances, profits have been so hard to come by in the low-margin environment at the base of the pyramid that companies' commercial initiatives have been quietly absorbed into their CSR efforts. That's what happened with Procter & Gamble's PUR water-purification packets after the company was unable to find a profitable distribution strategy and price. Microsoft's Unlimited Potential program also met that fate. After trying for a few years to eke out a profit by providing refurbished computers, internet cafés, and a scaled-down version of the Windows operating system to developing countries, the company passed some of these initiatives to its corporate citizenship group.

How to Entwine Commercial and Social Value

Many companies have simultaneously created private and public value in part through innovative business models that enlist community members or other organizations in distribution, access, payment,

and even security activities. Ensuring that such a model is both commercially feasible and sustainable over the long term involves streamlining operations and designing appropriate incentives for the people who are brought into the economic ecosystems that the companies have created. Let's look at some of these segment by segment.

In the low-income segment, examples of innovative, large-scale distribution strategies include M-Pesa's reliance on nearly 18,000 mom-and-pop retail operators to deliver its mobile money-transfer

Commercial and social value are like the two blades of a pair of scissors, and scale is like the tailor's deft hand.

service in Kenya; Novartis's mobilization of more than 20,000 volunteer doctors to visit villages, examine patients, and provide medicines as part of its Arogya Parivar ("healthy family") program in India; and Hindustan Unilever's investment in its army of door-to-door saleswomen. All three strategies depend on the companies' ability to provide incentives and support for the small retailers, doctors, and saleswomen who are integral to the distribution channels and, by extension, to the companies' business models and newly created economic ecosystems.

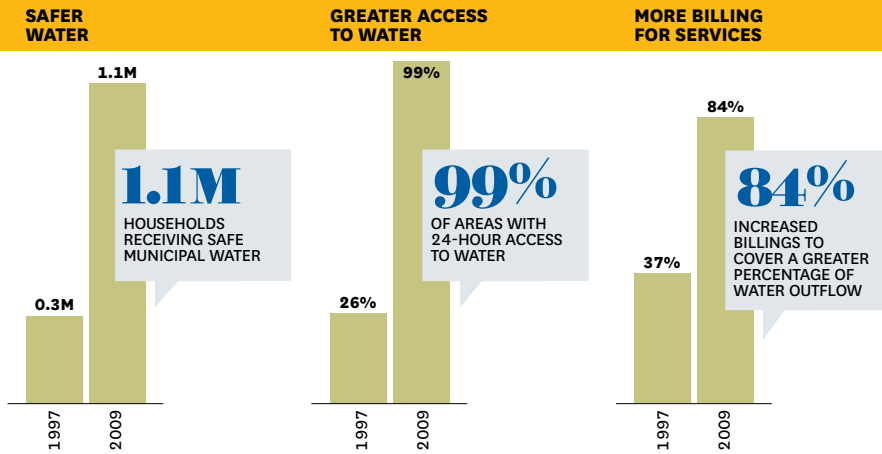
The California-based biopharmaceuticals manufacturer Gilead Sciences uses an innovative access strategy to produce powerful results. Of the estimated 35 mil-

lion people with HIV/AIDS in sub-Saharan Africa and South Asia in 2003, nearly 10 million were candidates for antiretroviral drugs. The medications were scarce in developing countries, but not primarily because of affordability—pharmaceutical companies were selling to poor countries at cost. The main stumbling block was a lack of access: Regulations governing registration, licensing, and importation of medicines were limiting availability.

Gilead, one of the world's leading suppliers of antiretrovirals, made the patents for two of its top products, Viread and Truvada,

available to 12 generic-drug manufacturers in India and South Africa—companies that could have copied the drugs under their governments' licenses to make them affordable to patients. Gilead didn't charge a fee for the technology transfer. It asked only that the manufacturers pay a royalty of 5% of the selling price on the generic versions of Gilead's drugs. These makers were able to produce the drugs much more cheaply than Gilead and to quickly break into markets in Asia and Africa.

Not surprisingly, Gilead's licensing program broke even in 2009, and by 2010 it had generated a \$5 million surplus and reached more than 1.4 million patients in low-income countries. In addition, Gilead has helped to create an ecosystem that will



aid these countries as they produce and distribute other essential drugs.

In the subsistence segment, people often lack essential information about new products or methods and are reluctant to adopt them. Companies must create demand for entire categories of products. A good example is the water purifier: Hindustan Unilever's Pureit can bring international water-purity standards to millions of homes that have neither running water nor continuous electricity. But many consumers aren't fully aware of the health benefits of purification, and those who are aware have a ready alternative—boiling their water—that seems a lot more affordable than a \$22 purifier. As is often the case in the subsistence segment, the access channel must play a role in generating demand. Hindustan Unilever relies on NGOs to both educate consumers and sell its purifiers.

Telecommunications companies such as Safaricom in Africa provide examples of community-based strategies for aggregating millions of small payments. Because consumers lack the cash to buy in bulk or pay a monthly fee, these companies provide airtime for cash up front and sell additional airtime through their networks of agents, usually small retailers. Instead of dealing with millions of consumers with millions of small payments, the companies rely on the agents to aggregate the financial transactions, thereby keeping operations economical and bolstering the economic ecosystem of the small retailers.

The mobile network operator Roshan provides an example of integrating com-

munity members into security operations. Before Roshan's founding, in 2003, only about 80,000 of Afghanistan's 34 million people had access to phones. The company established its presence by building eight stores and encouraging Afghans to form distribution networks that supply SIM cards and handsets to other consumers. The network has grown to more than 3,500 outlets, the subscriber base to 3.5 million users, and the pool of people directly or indirectly employed to more than 30,000. Roshan has recruited community leaders to monitor the security of its towers, which the Taliban threatens. The community leaders have multiple incentives to protect the towers: A functioning network provides jobs, training, and security fees. Roshan says this approach has saved it more than \$15 million a year.

Other companies, even while selling products and services to customers higher up in the pyramid, create tremendous value by extensively engaging the subsistence segment in their supply chains. Nestlé does it with dairy, Mars with chocolate, and Unilever with cooking and bath oils.

In the extreme-poverty segment, where delivering basic services such as water, sanitation, health care, and education requires heavy investments, companies have little choice but to enter into public-private partnerships that provide guarantees on cost recovery, subsidies, and market exclusivity. Without the partnerships, opportunities for profits are few, even in the long run. Because the needs of the extreme-poverty segment are for the basics (many people consider them funda-

mental human rights), a company should be careful to earn the community's trust by providing outstanding value, and that value should be the engine of profitability. (See the exhibit "Where Private and Public Value Intersect.")

Businesses also should not overlook the advantages of teaming up with locally established NGOs. The Geneva-based Global Alliance for Improved Nutrition, for example, has worked with some of the world's leading food companies to tackle hunger and malnutrition. Because of a lack of interest from commercial enterprises, GAIN took on the role of venture capitalist, providing seed money to facilitate businesses' development of products and markets for this segment. Among GAIN's partners are Unilever, Cargill, and Akzo Nobel. By providing both financial support and technical expertise, GAIN has ensured that staple grains in China and South Africa are fortified with essential vitamins and minerals. Building on pilot projects financed by GAIN, companies such as Britannia Industries have launched fully commercial product lines as part of their regular businesses.

WE DON'T mean to make this sound easy. The base of the pyramid is a risky place for companies. Indeed, well-meaning, well-financed ones have failed, as Microsoft did with Unlimited Potential. That, unfortunately, has been the fate of many such corporate forays as shareholders become impatient with money-losing ventures. But a strategy of creating private and public value while aiming for scale gives companies their best chance to succeed. Commercial and social value are like the two blades of a pair of scissors, and scale is like the tailor's deft hand. You must have all three elements to slice through the knotty obstacles at the base of the pyramid. ♡

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