

Emerging Markets, Emerging Models

MARKET-BASED SOLUTIONS TO THE CHALLENGES OF GLOBAL POVERTY

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EXECUTIVE SUMMARY



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Executive Summary



THIS REPORT INVESTIGATES “MARKET-BASED SOLUTIONS”

as a means to help those residing at the base of the global income pyramid. An alternative and complement to traditional government expenditures, aid, and philanthropy, market-based solutions give low-income people better access to socially beneficial products and services that genuinely and directly improve the quality of their lives and livelihoods. In India, for example, such solutions provide or enable:

- Clean drinking water at one-fourth the cost of the least expensive alternative.
- As much as a 125 percent increase in incomes for small farmers.
- Private education in urban slums that significantly outperforms the best government schools for about \$3 per month.
- Safe, doctor-attended births for a total cost of \$40—less than one-fourth the cost in traditional private hospitals.

Market-based solutions have recently attracted strong interest in the campaign against global poverty, in part due to the remarkable success of microfinance. They are relatively new, with an uneven performance record, and there is much yet to learn about what causes them to succeed or fail. The most successful pass two tests: they are self-funding, and they operate at sufficient scale to make a difference to masses of poor people. They also have one salient feature in common: a business model tailored to the special circumstances of markets at the base of the income pyramid.

READING BY SOLAR LANTERN

The poor participate daily in markets, whether for livelihoods, food, social services, or basic products like lamps and stoves. But these markets are often informal and provide low quality goods and services at a penalty. Market-based solutions are delivering better outcomes.

Emerging Markets, Emerging Models is addressed to those organizations and individuals most concerned with making a real and enduring improvement to the lives of the poor.

We hope entrepreneurs will find much of use on business models that work in low-income markets and how they work. We hope donors and investors will be encouraged to fund those ventures that have the characteristics and potential to help improve lives and livelihoods at the base of the pyramid. And we hope governments and aid organizations will recognize the promise of market-based solutions and act to encourage them.

“Soft” funding plays an important role in low-end markets and helped many of the successful enterprises examined in this report to reach scale — even some of those started by large corporations.

The report is based on Monitor’s extensive research into hundreds of market-based solutions around the world, with a particular focus on India, which is an advanced laboratory of approaches and an especially fertile source of lessons about performance. The research is based on dozens of site visits and hundreds of interviews as well as extensive work in the public record.

Monitor’s findings about the sources of success and failure of market-based solutions yield important lessons and conclusions:

- While the role of markets in the current global economic crisis is being reevaluated, market-based solutions in emerging markets have generated remarkable benefits to low-income people and offer enormous promise to do even more in the future.
- That promise depends on adopting the right business models, which must be tailored to the particular economic and social conditions of the poor. Business models that function well when dealing with affluent and middle-income customers are unlikely to work as well for low-income markets.

- As happened in microfinance, new entrants and small enterprises are more likely than large corporations to lead the development of market-based solutions in low-end markets. Large companies have other sizable, appealing opportunities in emerging markets that are not as challenging to serve. Exceptions will be large enterprises that engage poor people as suppliers, as these enterprises are best-positioned to organize extensive supply chains.
- Noncommercial or “soft” funding plays an important role in low-end markets and helped many of the successful enterprises examined in this report to reach scale—even some of those started by large corporations. In some cases soft funding may be the only way through which specialist business models can be developed, adapted, and tested.
- Meaningful scale is achieved in different ways but invariably takes time, especially if large corporations are not involved. Most small enterprises require at least a decade to reach significant scale. Market-based solutions, therefore, are not a quick fix to the causes and consequences of poverty, though they promise large, enduring benefits.
- The most common mistake among unsuccessful market-based solutions is to confuse what low-income customers or suppliers ostensibly *need* with what they actually *want*. Many enterprises have pushed offerings into the market only to see them fail. People living at the base of the economic pyramid should be seen as customers and not beneficiaries; they will spend money, or switch livelihoods, or invest valuable time, only if they calculate the transaction will be worth their while.

Emerging Markets, Emerging Models identifies seven business models, tailored to the circumstances of low-income groups, that we believe have the best chances of success.

Four business models focus on serving the poor as customers:

- A *Pay-Per-Use approach* in which consumers pay lower costs for each use of a group-owned facility, product, or service. This limits the impact on their cash flow while the sheer numbers of consumers makes the proposition sufficiently attractive for third-party providers.
- A pared-down, *No Frills service* that meets the basic needs of the poor at ultra-low prices and still generates positive cash flow and profits through high volume, high asset utilization, and service specialization.
- *Paraskilling*, which combines No Frills services with a reengineering of complex services and processes into a set of disaggregated simple standardized tasks that can be undertaken by workers without specialized qualification.
- Distribution networks that reach into remote markets via *Shared Channels*, piggybacking products and services through existing customer supply chains, thus enabling poor people to afford and gain access to socially beneficial goods such as solar lanterns or efficient kerosene burners.

The remaining three business models devise ways of engaging low-income suppliers or producers:

- A system of *Contract Production* that directly involves small-scale farmers or producers in rural supply chains. The contractor organizes the supply chain from the top, provides critical inputs, specifications, training, and credit to its suppliers, and the supplier provides assured quantities of specialty produce at fair and guaranteed prices.

- A variety of *Deep Procurement* setups that bypass traditional middlemen and reach into the base of the economic pyramid, enabling direct purchases from large networks of low-income producers and farmers in rural markets and often providing training for quality and other specifications.
- *Demand-Led Training* that applies a formal-sector “temp agency” model to down-market opportunities, with enterprises paying a third-party to identify, train, and place employees for job openings at the edges of the formal and informal sectors.

Emerging Markets, Emerging Models offers a range of recommendations for hastening the growth and success of market-based solutions. Although many of these models require time to reach scale, funders, investors, policy makers, and—most importantly—entrepreneurs can act now to smooth the path. They can help enterprises overcome common barriers to scale and commercial viability, such as startup costs, distribution challenges, availability of capital and credit, and the need to organize solutions at a systems level. Accelerating progress may entail interventions for smaller enterprises ranging from providing flexible, patient capital, to offering technical assistance, to addressing regulatory constraints. To encourage larger enterprises to participate, interested parties can fund new approaches to aggregating suppliers and customers and provide incentives for existing companies to share networks and channels. Finally, some steps will help spread the general approach, by cultivating the complementary field of impact investing, providing rigorous social impact metrics, developing shared assets that address barriers to scale, or simply asking tougher questions about what works—and what doesn't.

The report provides strong evidence that engaging the poor as customers and suppliers presents an exciting—and significant—opportunity to establish new paradigms to bring genuine social change in economically sustainable ways.

Introduction



SEVERAL YEARS AGO, Servals, a small company in Chennai, India, introduced a new product it believed would greatly benefit low-income consumers. Most such consumers cooked on kerosene burners and Servals' Venus burner used 30 percent less kerosene than conventional models. It also was smaller, safer, required less cleaning, and lasted more than twice as long in service. In short, it seemed like a clear winner, delivering significant savings of money and time.

Servals is a for-profit commercial enterprise that serves extremely price-sensitive customers. It is also a mission-driven company determined to deliver real value to its clientele. Taking into account the costs of developing the Venus burner as well as its benefits, it introduced the product for a price about double that of conventional burners, reasoning that it would pay for itself after about two months because of its superior fuel efficiency.

But sales of the Venus burner fell below expectations in the early stages. The biggest problem was distribution, compounded by a comparatively steep price. Servals couldn't convince retailers to invest in educating customers about the benefits of the Venus. As a result, a potentially great product that could have made life better for many seemed likely to fail because of a flawed business model.

Fortunately, this story has a happy ending. In 2006, Servals reengineered the product, lowered the price, and, most importantly, improved dealer margins and incentives. Sales of the Venus burner took off — crossing one million units in 2008 — and it's

A SELF-HELP GROUP IN ANDHRA PRADESH

Village women meet regularly to manage credit and savings for purchases of dairy cows and other income-generating assets.

WHAT'S IN A NAME?

Readers will note this report contains hundreds of references to low-income persons or groups as “the poor,” “poor people,” “low-income segments,” “low-end markets,” the “base of the pyramid,” and many other loosely synonymous variations. We recognize each of these terms may displease or dismay someone, somewhere, just as we recognize each term is thoroughly accepted: low-income people self-identify as “poor,” economics professors expound on “low-income segments,” economic and social NGOs refer to “impoverished peoples,” and so on.

But our intent isn't to satisfy a standard of political correctness. This report is keenly concerned to take low-income groups seriously as customers or producers, suppliers, and workers rather than as beneficiaries of someone else's largesse or assistance. Our hope throughout is to move away from typecasts toward a more nuanced consideration, based on data and actual conversations with potential customers and suppliers in low-end markets, of the lives and livelihoods of poor people and the ways in which these might be improved through market-based solutions.

now one of the most successful new products of its type in India. And it is materially improving lives of the rising numbers of low-income people who buy it.

What almost happened to the Venus burner is an all-too-common problem for companies that develop and market products and services for low-income markets. Servals thought a superior product would sell itself, thus ignoring business fundamentals, in this case failing to think through its distribution model and pricing. A great product idea married to a noble mission, however, is rarely enough to make meaningful progress in the face of massive social challenges like improving the lives and livelihoods of billions worldwide living in impoverished conditions. Success

requires business models that work in the particular circumstances of the bottom of the economic pyramid,¹ where consumers and channels to reach them are not only extremely price-sensitive, but also cut off from news and facts that might help.

In this context, business models that work are those that, when serving the poor as customers, are responsive to the limitations imposed by small, irregular customer cash flows and credibly address distribution questions. When engaging low-income segments as suppliers or producers, a successful business model will attend to the costs a low-income supplier may face in switching livelihoods, and to the cost of aggregating and managing large numbers of small suppliers. In this report, we've sought business models that promise to be:

- *Profitable* or at least self-sustaining without requiring continuous subsidy (otherwise, they're merely alternative forms of aid and dependent on the continuing generosity of donors).
- *Scalable* and thus able to reach and improve the lives of significant numbers of poor people (otherwise, the effort is like to trying to bail the *Titanic* with a tea cup).

Emerging Markets, Emerging Models is based on extensive research into sustainable business models for helping the poor through “market-based solutions”—our term for using the formal market economy to help improve lives and livelihoods at the base of the economic pyramid. Monitor surveyed more than 300 market-based initiatives, mostly in India, an advanced laboratory for enterprises serving low-end markets and for what succeeds and what fails in the effort. The research involved scores of site visits and hundreds of interviews as well as extensive work in the public record. In addition, we scoured the globe for other examples of business models that work at scale, or that promise to scale, in low-end markets. (See *About the Study*.)

A great product idea married to a noble mission is rarely enough to make meaningful progress in the face of massive social challenges like improving the lives and livelihoods of billions worldwide living in impoverished conditions.

In that process we found many examples of market-based approaches that seemed promising on the surface but upon further investigation proved not to be commercially viable or scalable. Some that met these two criteria turned out not to engage low-income segments at all. Given the level of ferment in India and other countries, we found everything from attempts to bid up the prices farmers receive at auction, to solar-powered weaving looms, to telemedicine and tele-prescription schemes, and all manner of efforts in between. From this much larger list of initiatives and

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models, we cut through the many that are interesting but lack promise to distill down to a few that have high potential.

In all, we identified seven business models that are self-sustaining and offer the promise to scale in ways that include the poor in markets and improve the quality of their lives and livelihoods. Four of these—*Pay-Per-Use*, *No Frills*, *Paraskilling*, and *Shared Channels*—present practicable ways of engaging the poor as consumers. Three others—*Contract Production*, *Deep Procurement*, and *Demand-led Training*—focus on engaging the poor as suppliers, producers, and workers. To our main text we've added brief, boxed descriptions of relevant initiatives—some successful, some not—from Africa, Southeast Asia, Latin America, and elsewhere.

This is a vibrant field, and other business models will emerge. Some will eventually reach considerable scale and be self-sustaining. The seven we focus on, however, promise those results now and can be adapted and emulated by enterprises seeking to help the poor through market-oriented approaches.

This report is organized in four major sections that follow.

- The first covers market-based solutions as a promising new approach to alleviating global poverty.
- The second details the seven business models that work in serving low-income customers or engaging the poor as suppliers, producers, and workers.
- The third derives general themes and lessons from the business models.
- The fourth outlines implications, conclusions, and recommendations for constituencies most interested in addressing challenges of global poverty and hastening the spread of market-based solutions.

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ABOUT THE STUDY

This report is based on a multi-year research project funded by eleven sponsors interested in new approaches to economic development and social change. We are grateful to ICICI Bank, IDFC Private Equity, IFC, Omidyar Network, Orient Global, the David and Lucile Packard Foundation, PATH, the Rockefeller Foundation, Sir Dorabji Tata Trust, Swiss Agency for Development and Co-operation, and TPI for their support.

The original project involved a year-long analysis carried out by Monitor's Inclusive Markets practice based in Mumbai, India (www.mim.monitor.com). The starting point was the belief that the "next microfinance" is out there, and that other market-based approaches may help address pressing issues of poverty and development in a commercially sustainable fashion.

Initial investigations in India, the Philippines, South Africa, Brazil, Kenya, and other countries revealed no shortage of market-based approaches that claimed to be profitable or financially self-sustaining. Many seemed exciting, innovative, and groundbreaking. On closer inspection, however, we observed that many were struggling financially and most served a few thousand people, a drop in the ocean given the millions living in conditions of extreme poverty. Only a tiny fraction of market-based initiatives have reached numbers of people commensurate with the scale of the problems they aim to address.

We knew from Monitor's commercial practice that succeeding at a large scale is far more

difficult than succeeding in small markets.

Consequently, two fundamental questions guided our research: 1) Why have so few market-based solutions achieved scale? and 2) What are the business models — across sectors — that show promise of achieving scale?

We set about to answer these questions in three phases of work. We began by focusing on India, a pacesetter among emerging markets, with a high degree of social entrepreneurship, strong NGOs and entrepreneurs, general openness to new ways of addressing development, and a huge addressable market.

We also chose to focus on market-based solutions that offer "socially beneficial" products and services for poor people as customers. Obvious categories included education, health care, financial services, water and sanitation, insurance, clean energy, and telecommunications. We also considered products that appear to have less immediate benefit but still improve quality of life, such as efficient cook stoves, which offer second-order health and economic advantages — less soot, less time to clean, and less energy consumed.

We ruled out products that might arguably convey second-order social benefits but only tangentially so, or that in many cases had sticker prices that rendered them unaffordable to lower income segments. We therefore excluded products such as soap, washing powder, shampoo, batteries, televisions, motorbikes, and automobiles. We arrived at this decision because we did

not wish to produce yet another study simply about marketing to the poor.

In the first phase, we inventoried more than 160 different market-based approaches run by large corporations, small startup enterprises, NGOs, and other entities such as cooperatives, government agencies, and non-bank financial companies. Based on this investigation we identified the most promising business models for in-depth investigation, and over the course of the rest of the project we examined an additional 120 distinct examples. (See the Appendix for additional details on the study.)

The second phase involved in-depth field research into 36 initiatives to help validate and generate most of the data. These detailed reviews included original customer research (both survey and focus

groups involving more than 600 customers and small producers), evaluation of substitutes, interviews with management, interviews and economic modeling of competitors, and in-depth discussions with participants in the supply chains and value chains from sales forces down through distribution warehouses. These analyses covered initiatives all over India, at different sizes, levels of maturity, in urban and rural contexts.

In the third phase, we carried out a combination of primary and secondary research to identify and analyze comparable market-based solutions in other countries, where we started with over 30 additional examples for investigation from 19 countries. (See map.) These initiatives are both instructive in themselves and confirm that the business models apply independent of geographical context.



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