Low Income Consumers: How to Profit from the Biggest World Market of the Future

Adriana Acevedo and Humberto Sanchez

With growth opportunities becoming scarcer by the day in so-called developed countries, many globally active companies are wondering how to explore growth in low income regions. But the hitherto common model of simply trying to sell older models doesn't work, as consumers in these areas have different needs. In this article the authors explore what companies can do to seize the huge opportunities in these immense and promising markets.

A lot of publicity has been given in recent years to the big business opportunity represented by the vast population at the lower end of the income distribution gradient – what some people label the poor, the bottom of the pyramid (coined by authors C.K. Prahalad and Stuart Hart), or the term we prefer: low income consumers, LICs. While the arguments for targeting this underserved market are beginning to be more widely recognised and accepted, few people have proposed pragmatic ways for a company to start taking this segment into consideration. Much of the attention has focused on documenting successful and creative case studies, but most of those approaches are hard to replicate in a different context.

At Arthur D. Little, by analysing a wide range of these success stories, working side-by-side for many years with companies in developing markets, asking companies that have tried to service this segment about their experiences and setting out to help clients in the specific challenge of developing strategies for LICs, we have developed several guidelines that can help an executive answer the question: "Ok, I understand there may be an opportunity in serving low income consumers, but where do I start?"

The Opportunity

Several business researchers and authors have recently argued that emerging markets and in particular LICs represent not just an interesting segment but, in fact, "the biggest market opportunity of the next 50 years" (Vijay Mahajan)*. A few interesting numbers help support this argument. One that is frequently quoted is that, taken together, nine developing nations - China, India, Brazil, Mexico, Russia, Indonesia, Turkey, South Africa and Thailand - have a combined GDP that is larger, in purchasing power parity, than the combined GDPs of Japan, Germany, France, the UK and Italy.

* V. Mahajan 2005. The 86 Percent Solution: How to Succeed in the Biggest Market Opportunity of the Next 50 Years.

In terms of population, LICs represent between four and five billion people, or two-thirds of the world. And even if their average income, estimated at under $1,500 per year, is a small fraction of that of developed countries, taken together these low income consumers represent a multi-trillion dollar market. Emerging markets also have higher rates of population growth than developed countries, and have the opportunity for higher income growth rates due to their lower relative starting base and the gains achieved through globalisation and widespread market reforms.

But size and population growth are not the only elements that make low income markets attractive. Hyper-competition in traditional market segments, i.e. consumers in developed countries and higher-income inhabitants of emerging market, is making it ever harder for businesses to achieve profitable growth.

The opposite is true of LICs. For decades neglected by the businesses of the world, low income consumers remain a widely under-served segment. This absence of business interest, combined with many structural and cultural barriers, has had the unfortunate effect of forcing LICs to pay what is referred to as a "poverty penalty". In other words, not only do the poor have lower incomes, but they actually pay more for the few goods and services they do get. For the companies that can effectively break through the difficult challenges of serving this segment, a market that has the potential for high profitability and few competitors awaits.

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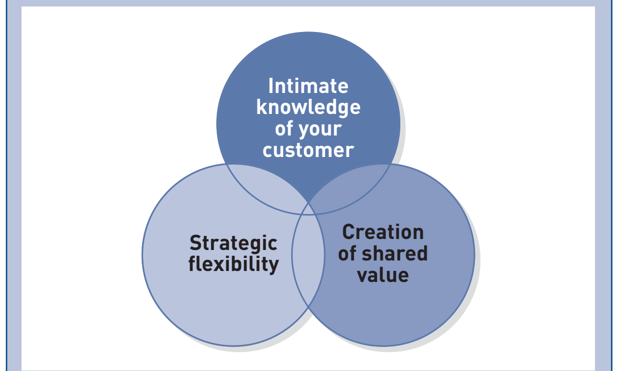
Being an attractive business opportunity is just one side of the argument. The other is about development. From this viewpoint, businesses (in particular large multinational corporations) have a great opportunity - and, according to a growing number of people, a responsibility - to use their vast resources to generate wealth in the communities they serve. This goes beyond the traditional perception of corporate social responsibility as "charity". The contribution is made precisely through the core of the business: by providing goods and services that meet the needs of the consumer, by devising business models that creatively and profitably bring down the access barriers to LICs.

This completes the promise: a great virtuous interrelationship between businesses and communities, in which both gain from each other. Hence the subtitle of Prahalad's book The Fortune at the Bottom of the Pyramid: "Eradicating Poverty through Profits".

However, there are good reasons that have kept the focus of businesses away from LICs. Serving the poor profitably is hard. Access barriers are real. For every success story found in the literature, there may be countless failures that are not on record. Yet, waiting to catch a "second wave" after seeing how it goes for the more daring pioneers may imply risking, if nothing more, a key to success, namely loyalty ties, which worldwide seem to grow stronger in low income customer segments than in the upper levels of the social gradient.

Exhibit 1 Keys to Unlocking the Pent-Up Value of LICs



Source: Analysis by Arthur D. Little

So what is a company to do? How can a business systematically approach this segment and find out if there are real opportunities to be exploited? While there is no magic formula, our research at Arthur D. Little has found three elements that are the key to unlocking the pent-up value of LICs: intimate knowledge of the consumer, strategic flexibility and creation of shared value (see exhibit 1). These elements may sound no different from what is required to service other segments, yet the way they apply to LICs entails radical innovation and a break from today's common business practices. And it all starts by getting to really know your new target.

Intimate Knowledge of the Customer

The truth is that most companies today know very little, if anything at all, about LICs. Our research has shown that most companies, even locals and multinationals that have been operating in emerging markets for long periods, have very little knowledge about this segment. They have largely concentrated only on the middle and upper tiers of the income distribution ladder, and have had only peripheral contact with LICs. For the most part, all they have is a long list of greatly biased, pre-fabricated ideas.

Perhaps the most common misconception about LICs is that the reason they don't buy more of a particular product or service is because they don't have enough income. It seems the most logical conclusion; after all, most definitions of poverty are based on whether a family has enough income to cover basic needs. It follows that if a family can barely cover basic needs, it will hardly have enough to afford anything else.

The underlying assumptions of that argument are that LICs have exactly the same needs as rich consumers, but no income to afford them, and that all of their income is necessarily spent trying to satisfy basic needs. Our research and work experience has shown that this is simply not true. On the one hand, LICs have needs that are specific and different from any other consumer group; and on the other, LICs consistently choose to use part of their income for non-subsistence items.

The bottom line is that you don't know what the customers want and you can't even ask them because they may not know either. You need to get close to your customers, to get to know them intimately.

As the case of Whirlpool illustrates, part of the challenge is that no one in your marketing department or in most market research companies will probably really know ahead of time what the particular needs of a market are. Interestingly, even consumers themselves may not be fully aware of them. Consumers have had needs that they have never seen a product meet, so they do not necessarily realise that a product that meets those needs could exist. Muhammad Yunus, the founder of Grameen Bank and considered by many the father of modern microfinance, used to tell his salespeople that anyone who asked for a loan was not part of the target. The real target would shy away from anyone trying to lend them money, for in their experience moneylenders were people one should stay away from.

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Whirlpool Brazil: Understanding Needs and Aspirations

Consider the case of Whirlpool in Brazil. Whirlpool is a home appliance manufacturer and distributor. Its first strategy to try to increase washing machine penetration in Brazil was based on the most obvious tenet: reduce prices. In order to do so, Whirlpool tried selling older models that offered fewer features and needed fewer components involving new technology and thus could be offered at a lower price. The results were not at all encouraging, as penetration was not increasing. A 1998 launch of a US $ 300 model was a failure. Brazilian LICs did not just need a cheaper product. They intuitively wanted a product that fitted their particular needs.

Whirlpool started to listen more closely to consumers. A few things that may seem obvious in retrospect but that no one had anticipated started to surface. Older models were big, bulky, heavy and energy-inefficient - features that were particularly off-putting for LICs with limited space, difficult access to their shantytown homes (frequently only by foot beyond a certain point) and uneven electricity service. Moreover, LICs' wardrobes were smaller than those of more affluent consumers. Consequently, doing laundry normally became a daily task - as opposed to the weekly standard of wealthier consumers. So LICs did not need large-load capacity washers after all. What they needed was smaller, energy-efficient washers that could be used every day.

Other “nice-to-haves” were also identified and featured into the new design. A transparent acrylic lid (cheaper than metal or glass) allowed the user to still watch over the washing process. And the newer look of these machines responded appropriately and respectfully to the higher-status expectations of the Brazilian consumer, for whom surveys had shown washers to be the second most wished-for item after mobile phones.

The results for Whirlpool? After some serious re-thinking and a considerable investment of time and money, including the development of new technologies designed specifically to meet the identified needs, the company managed to create the world's cheapest washer, reducing costs by 80 percent. More importantly, the washers came closer to satisfying the particular needs of LICs better than any alternative in the market. The product, originally developed in Brazil, was also launched in India and China. Certain modifications were made in both cases to respond to the particular needs and expectations identified for the Chinese and Indian LICs. The washers have proven very successful and three years later remain one of the products spearheading the growth of Whirlpool in emerging markets.

Source: Arthur D Little analysis

Cemex of Mexico, one of the most emblematically successful companies in serving LICs, reportedly made this realisation very clear and started by issuing a "Declaration of Ignorance" about the segment. After openly admitting its ignorance, it became better prepared to really delve into the life of the consumers and truly understand their needs, from their perspective.

Intimate knowledge of the consumer means going beyond statistics and market surveys that only scratch the surface. To begin uncovering the barriers that may be keeping LICs from accessing your products or, to put it another way, the barriers that may be keeping you from meeting their needs, is possible only by understanding, in depth, the way LICs live - their daily routine, their values and traditions, their expectations, their fears, their surroundings, their everyday constraints, the innovative alternatives they alone have come up with to surmount those constraints and the shortcomings of such alternatives.

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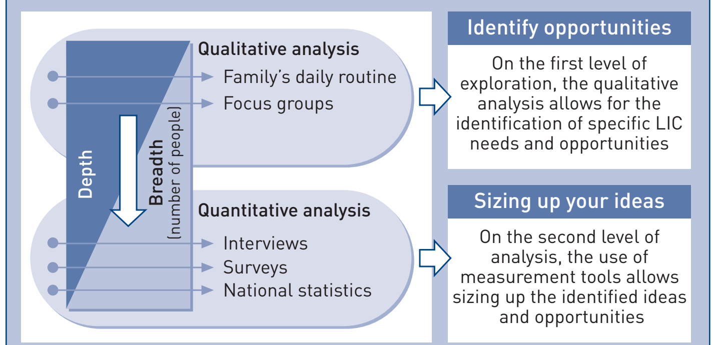
Attaining this level of intimate knowledge and understanding of LICs requires an investment of time and money. There is a variety of techniques that have proven useful for this purpose, as stand-alones or combined, with different levels of interaction and depth, such as actually living with families for a period of time, writing up "life stories" about LICs, performing in-depth interviews and focus groups - held as closely as possible to the regular environment of the consumer - and otherwise fostering natural, lengthy, direct interaction with the new target (see exhibit 2).

Exhibit 2 **Increasing Intimate Knowledge and Understanding**



Source: Analysis by Arthur D. Little

Four key elements need to be considered to make these techniques work:

1. **Keep an open mind.** Preconceptions will give you a hard time when identifying opportunities. Remember that you are there to learn.

2. **Strive to get as close as possible to the consumer's real life, without interfering with it.** If you deviate even slightly from their normal life, you lose something. Just being watched may change behaviour, being asked questions may change answers and being around strangers may change everything.

3. **Get the people who can make your strategy happen involved in the process.** A report from a market research firm may give you clues, but it is a poor substitute for having personnel from your own business directly involved in the process.

4. Last but perhaps most importantly, **strike a balance that works for you and your company.** "Perfect" research for LICs may take too long, be too expensive or be plainly impossible for your people to participate in directly. So you will have to compromise.

Getting advice from non-traditional sources can help you make compromises that make sense. Many LICs tend to think in very concrete terms, and their answers to most questions are based on their personal experiences alone. In order to make sensible compromises, you will need to gain a perspective on the overall dynamics of the community, which requires a certain level of abstraction. Thus, while helping clients to devise strategies for LICs, at Arthur D. Little we have turned to non-government organisations (NGOs), sociologists, social anthropologists and community leaders to get such a wider perspective. The variety of sources that can provide highly useful and reliable information about what goes on in the life of low income communities may very well surprise you.

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Yet you need to bear in mind that no amount of time spent studying the consumers will ever give you "the right answer". The best you can hope for at this point is a good set of hypotheses. The rest you will need to learn as you start implementing your ideas. That's where strategic flexibility comes into play.

Strategic Flexibility

Serving LICs profitably requires that you build flexibility into your strategic planning and implementation processes. That usually means looking at your strategy in a new way. Most companies put a lot of emphasis on choosing the right strategy and only then implementing it. The underlying assumption is that you can, through careful analysis, maximise your chances of success. The problem when you are getting into uncharted territories is that many times no amount of previous analysis can really maximise your chances of success. You just don't know enough, a priori, to be able to tell the good strategies from the bad. You have to learn as you go.

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Of course, that does not mean throwing analysis out the window. It simply means shifting the focus from making the right selection for increasing your chances of success to ensuring the right implementation that maximises your chances of making it work. That means minimising the costs of intermediate - but inevitable - failures and enabling the business to make adjustments based on the new information and learning that you gather as you implement. These adjustments may take the form of challenging assumptions that the industry takes for granted, forming alliances with unusual partners or even looking outside your own industry for opportunities that you can take along the way.

The microfinance industry is a field in which you can find extensive examples of strategic flexibility at work. Increasing access to financial services for the poor is one of the areas that has proven the viability and profitability of serving LICs for some time. From its beginning, which is credited to Muhammad Yunus some 30 years ago, lending money to the poor required the flexibility to break away from traditional industry practices that considered poor people “unbankable”.

Strategic Flexibility at Work

While banks in India such as ICICI Bank and State Bank of India have focused on forming and servicing “self-help groups” of 10-15 people, institutions such as ABN Amro (through Banco Real) in Brazil and Bangente in Venezuela have found that their targets - mostly the urban poor in Sao Paolo and Caracas - were more individualistic and better served by one-by-one relationships. Banks like Citigroup decided to use the help of Compartamos, an NGO in Mexico, to get into the segment, while institutions like Mi Banco in Peru and Prodem in Bolivia were originally NGOs that became banks in the process of serving the segment. In order to extend the branch network to reach customers, Bradesco in Brazil decided to join forces with the postal service, creating Banco Postal, while Banco Popular do Brasil created a network of “correspondents” that have converted many supermarkets, drug stores, and construction material stores near low income communities into bank “branches”.

In terms of industry cross-overs, Grupo Elektra, the largest chain of appliance stores in Mexico, saw an opportunity to sell more products through consumer financing, eventually leading to the creation of Banco Azteca, now one of the largest banks in Mexico, offering a full range of financial services. Smart Communications, the mobile telephony arm of Philippine Long Distance Telecommunications, also detected an opportunity to enter the financial sector by offering mobile banking services. Forming alliances with MasterCard it created SmartMoney, a mobile payments solution, and SmartMobileBanking, a service to receive financial information and make transactions over the phone. Smart also forged alliances with several international banks and money-transfer companies to create Smart Padala, an international money-remittance service via SMS. And the cross-overs can go both ways. To end up where we started - yet in a place where Muhammad Yunus never anticipated his bank would wind up - Grameen Bank also discovered an opportunity to provide phone services to the poor and created Grameen Phone, offering GMS service and village phones, in close association with its banking operations.

None of these companies could have known in advance how their businesses were going to end up operating. They gathered new information as they implemented their original strategies, and had the flexibility to adjust in mid-course to avoid losses or take advantage of unforeseen opportunities.

Microfinance has since grown into a recognised industry sub-segment and initiatives have spawned all over the world, attracting interest even from large traditional commercial banks. Yet many institutions trying to replicate the model started by Grameen Bank have required or benefited from a considerable amount of strategic flexibility in order to adjust to local needs or take advantage of previously unseen opportunities.

To make strategic flexibility work in a pragmatic way, you need the right set of tools. Several alternatives exist, with real option evaluation, discovery-driven planning, strategic portfolio monitoring and decision trees being among the most widely known. These tools can offer differing degrees of insight and be applicable to different situations, but they all share one element: the central question of “How do I learn what I need to know to go on, as soon and as cheaply as possible?” and then “How do I adjust based on what I've learned?”

We believe creating shared value is not just the responsible thing to do, but is the only thing you can do if you want to be successful in the long run.

Once you have gained intimate knowledge of the consumer to get a set of good working hypotheses and developed a strategic plan based on flexibility to test these hypotheses and maximise your ability to make them work, you will definitely be closer to finding out if you can profitably serve low income consumers. But you will need one more key to truly unlock the hidden value of LICs: you need to share the value you create with the community you try to serve.

Creation of Shared Value

There are several arguments to support the creation of shared value as a key part of serving LICs. One of the most common is related to corporate social responsibility. This argument takes many forms, and in general it proposes that a business has a responsibility to all its stakeholders, and not only shareholders. While this is a very valid argument, we believe creating shared value is not just the responsible thing to do, but is the only thing you can do if you want to be successful in the long run.

Addressing LICs' problems and barriers requires sharing the value created with the community so they can spend it on further business with your company. It is a virtuous circle in which your customer becomes your strategic partner.

This insight has implications for development as well as for business purposes. Some findings about two of the sectors mentioned, financial services and telecommunications, help to drive home this point. A World Bank report published last year shows a strong correlation between lack of financial access and low incomes. Earlier research concluded that a sound financial system boosts economic growth and particularly benefits people at the bottom end of the income gradient. In yet another recognition of the role of financial services in development, the United Nations declared 2005 the “International Year of Microcredit” within the context of the Millennium Development Goals. As for telecoms, a London Business School study found that a rise of 10 mobile phones per 100 people boosts the rate of GDP growth by 0.6 percentage points a year in a developing country. Thus it is clear that as LICs begin to get better services, their productivity increases, as do their incomes, making both their lives and your potential markets richer.

There are also cultural barriers to overcome. People in poor communities have developed low levels of trust of outsiders because outsiders have often exploited them. Often they don't think of themselves as poor, and they usually tend to think of their communities as at least a bit safer and better than neighbouring places, providing mutual validation.

There are also cultural barriers to overcome. People in poor communities have developed low levels of trust of outsiders because outsiders have often exploited them. Additionally, any sense of belonging to a community in the difficult conditions in which poor people live requires dealing with cognitive dissonance, which can be achieved by looking more positively at people from inside the community and more negatively at people from the outside. Often they don't think of themselves as poor, and they usually tend to think of their communities as at least a bit safer and better than neighbouring places, providing mutual validation.

This mistrust of outsiders is exacerbated in the case of businesses. If you want your strategy to succeed you need to break through that barrier. The best way to do that is to have people from inside the community validate your business model. And what better way to find validators than having them as co-participants in value creation?

To see how this process works, it is useful to look at how poor communities validate informal business models. Most LICs do not consider the local shopkeeper or money lender a “bad person”, even if he may charge more than 100 percent mark-up on products or over 25 percent monthly interest rate. In their view, these people are making the best living they can, just like everyone else in the community, and the fact that they still live in the area is proof enough that they are not making an unfair profit. A woman living in a shantytown of Caracas pays a kiosk tender at the bottom of the hill about 20 percent of the value of a cooking gas tank, just for holding it until she comes home in the evening. She is thankful for this service. It constitutes her only option for having cooking gas, as it is impossible for the delivery truck to bring it up the long stretch of steps to her house.

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Refreshing Latin American LICs

Kola Real saw an opportunity as some of the traditional multinational firms started to withdraw from certain areas of Peru because of the frequent truck hijackings and kidnappings by guerillas. Kola Real decided to turn to informal, independent local distributors - pretty much anybody with a truck - to deliver a low-cost soft drink. Not only did the company offer the lowest price in the market but it also managed to be the only brand present in some areas of the country, and in the process shared the benefits with the local informal distributors.

The local micro-entrepreneurs to which Kola Real delegates distribution are the way to break the access barrier and achieve fast growth, while lowering investment requirements for the company and hence the cost of the product. For these partners, Kola Real generally applies the rule “one truck - one distributor”, favouring small operators and broadening job opportunities to the largest possible number of people.

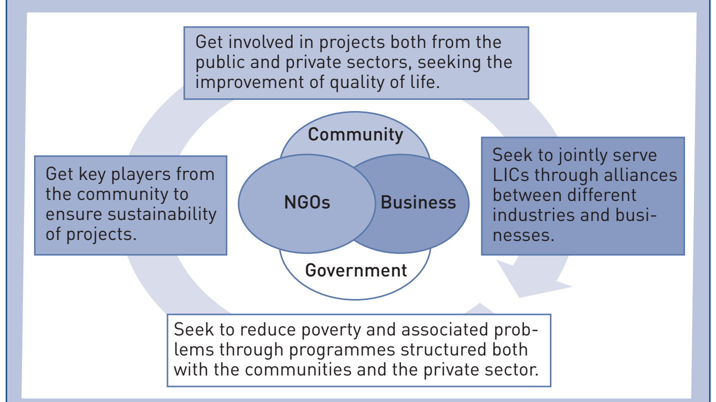
Positioning its products as “quality at fair price”, Kola Real has not only gained validation but has also captured nearly 20 percent of the soft drink market in Peru, where it reaches 180,000 points of sale. It has also successfully entered the Venezuelan, Ecuadorian, Costa Rican and Mexican markets with the same business.

One company that has been able to get validation from the community is the AjeGroup, a soft drink manufacturer from Peru better known as Kola Real for its star product (see insert).

The most successful telecommunications companies in the region are those that have succeeded in controlling their costs, straightening their cost side to market-oriented structures, after the consolidation of market shares and revenues in the past.

Similar successes were achieved by Arvind Mills and Hindustan Lever, HLL (a subsidiary of Unilever) in India. Arvind introduced a ready-to-make kit of jeans components distributed through a network of thousands of local tailors who finished the jeans and sold them to the end consumer. Arvind rapidly became the largest-selling jeans company in India. Although the business initiative later evolved into a different model, its unique approach proved both efficient and innovative for a long period. HLL also employed an innovative distribution system to rural areas through Project Shakti (meaning strength, power, force, and feminine energy). Shakti works in close cooperation with women's self-help groups, providing critically needed additional income to their families by equipping and training them to become the distributors of HLL products in rural areas. Started in 2001, Shakti has already been extended to about 50,000 villages and has some 13,000 women entrepreneurs in its fold.

Exhibit 3 **Forming Alliances**



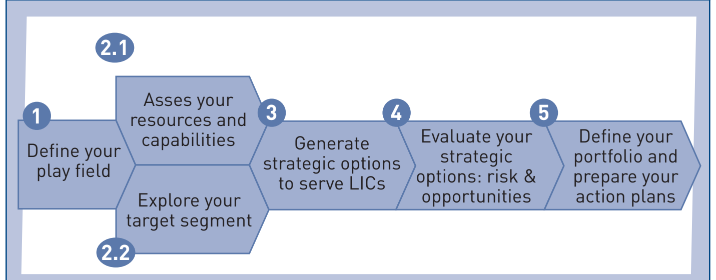
Source: Analysis by Arthur D. Little

Insights for the Executive

Serving low income consumers profitably can be a great challenge but not an impossible task. Companies can greatly maximise the chances of making any initiative to serve this segment work by grounding their innovation on the three key factors explained in this article: intimate knowledge of the consumer, strategic flexibility and the creation of shared value.

To unlock the hidden value of the world's next largest market, you are advised to follow a structured process (see exhibit 4). It is based upon our experience in helping clients explore LIC business opportunities, walking side-by-side with them along the path from segment definition and exploration to strategic option valuation, and to action plan implementation.

Exhibit 4 **Path to Unlocking Hidden Value**



Source: Analysis by Arthur D. Little

Following such analysis and careful understanding of the needs of the consumers, and after testing reasonable hypotheses that incorporate the creation of shared value, a company may decide that it is not possible, desirable or the best use of its resources to target LICs in the immediate future. In the end, as we have said, this is uncharted territory, and nobody yet knows its boundaries. Your company may happen to be in an industry or have a combination of resources and capabilities that are better fit for other markets in the short term.

We believe every company owes it to all its stakeholders to consider the possibility of LICs seriously. The segment is too big, growing too fast, and too uncontested to ignore. The companies that learn earliest how to sail in these waters will be much better equipped to exploit the opportunities that are inevitably bound to appear in emerging markets in the future. You do not want your company to miss out on the biggest market opportunity of the future just because you did not know enough and thought it was too complicated to find out.

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