If the bulk of humanity has been left out of the formal economy, imagine the potential of this untapped market. The poor at the 'base of the pyramid' are being viewed as a viable opportunity, but the new business models that are needed are not just coming from the top down. In a reversal of the trend of developed world corporations selling into emerging markets, disruptive innovation is now coming from the base of the pyramid itself.

The numbers are huge. Estimates of the size of the base of the pyramid range from 2.5 billion to 5 billion people. And in terms of income, it can refer to those on less than $2 a day – the standard measure of poverty – or it can be more elastic and stretch to $5 a day. "The definition is more behavioural," says Stuart Hart, professor emeritus of management and organisations at Cornell University. "The bottom of the pyramid is those who live primarily in the informal economy."

Mr Hart, along with the late CK Prahalad, is a founding father of base-of-the-pyramid thinking, which viewed the poor as value-conscious consumers who should be targeted by multinationals looking for new sources of growth. The rewards sounded promising in their 2002 paper The Fortune at the Bottom of the Pyramid.

A WIN-WIN SCENARIO
"The bottom of the pyramid is a seductive idea," says Aneel Karnani, associate professor of strategy at the University of Michigan. "You can become rich by selling to the poor and the poor will be better off. You can be a saint and rich all at the same time," he adds. Mr Karnani, a critic of the bottom of the pyramid idea, argues that it is a failed promise and it romanticises the poor.

At worst, the bottom-of-the-pyramid idea has been described as a form of Western corporate imperialism. "That was never the idea," says Mr Hart of his original writing. Now, with more than a decade of putting the ideas into practice, bottom-of-the-pyramid has evolved into version two. "Selling to the poor has not been a successful approach, unless the proposition is so powerful or it is addictive like cigarettes," says Mr Hart. Rather than adapting products from developed markets and making them cheaper, the new approach emphasises building trust-based relationships with poor communities. "Rather than air-drop in products, this is a more embedded, co-creative approach," he adds.

Vijay Govindarajan, a professor of international business at the Tuck School of Business at Dartmouth College, says that innovating for the base of the pyramid is not just about making products affordable, but addressing the needs in the market. He gives the example of wheelchairs, which, when used in emerging markets with poor infrastructure, have to be designed for unpaved streets.

Such design breakthroughs are occurring at the base of the pyramid in a process of 'reverse innovation'. In a paper that he worked on with Jeffrey Immelt, CEO of the multinational GE, Mr Govindarajan outlines how GE has been disrupting itself to adapt to the challenges of the base of the pyramid. GE had an ultrasound machine that cost $100,000 and sold poorly in developing markets, and so the company tasked a local team in China to develop a cheaper, portable machine. By 2007 the price point for this device had come down to $15,000 – more appropriate for the base of the pyramid – and in the final stage of the reverse innovation, GE then found uses for this portable product in developed markets.

MEETING THE CHALLENGES
For multinationals that do not disrupt themselves in this way, there is a danger they will lose out to challenger companies from emerging markets that have a closer understanding of the bottom-of-the-pyramid market. Mr Hart gives the example of Chinese company Tsinghua Solar Systems, which has developed solar energy products specifically for poor people not on the electricity grid. Mr Hart anticipates that the popularity of the
The greatest bottom-of-the-pyramid success stories so far, says Mr Hart, are the spread of mobile phones and microfinance, which are both enablers of further innovation. “One of the really powerful things about microcredit was the business case for serving the poor,” says Rodger Voorhies, director of financial services for the poor at the Bill and Melinda Gates Foundation.

Tilman Ehrbeck, CEO of the Consultative Group to Assist the Poor, agrees. “Microcredit proved that the poor base of the pyramid is bankable, [these people] have financial needs and it can be done at scale in a way that is sustainable,” he says. Mr Ehrbeck estimates that half of the world’s population is living and working in the informal economy. These people, he says, have active financial lives and the services that are available to them – such as informal savings clubs or loan sharks – are often unreliable and expensive relative to the small ticket size.

**FINANCIAL TARGET**

In terms of creating financial services for the base of the pyramid, Mr Ehrbeck explains that it is different from other industries targeting this segment. “People will buy pharmaceuticals because there is incredible demand – there is no alternative. When it comes to financial services there is an informal alternative so the formal has to be better,” he says. “When we find ‘killer apps’ they take off like wildfire – M-Pesa met the real need for fast and secure money transfers,” he says.

The success story of Kenya’s M-Pesa – a mobile phone-based money transfer service – has been well documented and now that the payments infrastructure is in place, other layers of innovation are being built on top of it to serve the bottom-of-the-pyramid market.

For example, M-Kopa Solar, a solar panel company, allows people to buy on hire purchase and pay back the sum in instalments, which has been made possible because of the existence of the mobile money transfer scheme of M-Pesa. As well as being a sustainable business model, M-Kopa has the knock-on effects of providing a cleaner, renewable alternative to kerosene and it also helps poor households save money in the long run. They can also earn additional income by using the solar panels to charge their neighbours’ mobile phones.

In another development that builds on M-Pesa’s business model, the Commercial Bank of Africa now offers M-Shwari – mobile micro-banking services such as loans and deposits – to M-Pesa customers.
PRIVATE ROLE
With mobile technology and digital payments, new opportunities have opened up in serving the bottom-of-the-pyramid segment. Mr Voorhies says that the underlying economics need to be addressed in making financial services for the poor more attractive to the private sector. Payments, he says, are the “connective tissue” and he points to the work of the Better than Cash Alliance (BCA), which is advocating that governments, the private sector and development community move to electronic payments. In an example of the cost savings that are possible, the BCA estimates that the Mexican government has been able to save $1.27bn a year by distributing its payroll, pension and benefits payments electronically.

Mr Voorhies says that by addressing the economics of banking the poor, non-profit organisations can motivate the private sector to follow. He says that philanthropic capital helps accelerate access to innovation in poor communities, creates demonstration cases so that the private sector can see what the business case is, and provides data on the impact of the projects.

Like the Bill and Melinda Gates Foundation, the Asian Development Bank (ADB) also views the bottom of the pyramid through the lens of reducing poverty. And the ADB also seeks to involve the private sector in achieving its goals. In 2010, the development bank launched the Inclusive Business Initiative, which aims to stimulate the private sector in creating shared value through business models that are profitable and fight poverty at the same time.

Bart W Édes, the director of the poverty reduction, gender and social development division at the ADB, elaborates on the role the private sector can play in fighting poverty. “Most major Western companies have corporate social responsibility initiatives, but that is a drop in the ocean [compared to what is needed] – that is not a model you can sustainably scale up,” he says. For the non-governmental organisations and non-profit organisations, “their traditional sources of funding are drying up and they cannot get the grants as easily as in the past. They need to use market-based methods to accomplish their aims,” says Mr Édes.

Mr Édes explains that new goals to reduce global poverty are being developed as the UN’s Millennium Development Goals approach their 2015 deadline. “It will not be possible for these new goals to be met with traditional sources of funding,” says Mr Édes. “We have to look to new sources of funding and the private sector is a new means of meeting those development objectives.”

MICROFINANCE OPPORTUNITY
The private sector is looking for viable business opportunities in the base-of-pyramid segment, and banks are increasingly viewing the poor as a potentially profitable market. Microfinance may have started with a social mission to reduce poverty, but now it is being viewed as a business opportunity.

Robert Annibale, global director of Citi Microfinance, says that the bank’s involvement in microfinance grew out of its presence in emerging markets in places such as Chittagong in Bangladesh, the birthplace of Grameen Bank.
and its now-famous model of microfinance. Citi’s support for the sector initially started as a philanthropic activity through Citi Foundation and later evolved into a business line for the bank as microfinance institutions (MFIs) began to be viewed as clients rather than beneficiaries of a corporate social responsibility programme. Citi Microfinance was established in 2005 and provides services to MFIs such as access to funding and payment systems, foreign exchange hedging and securitisation.

When asked if banks are increasingly viewing the base of the pyramid as a business opportunity, Mr Annibale says that there is not an equivalent to Citi Microfinance at the other global banks. He adds, however, that local banks in various emerging markets are getting more engaged in serving this segment. “Technology is an enormous enabler,” says Mr Annibale. “When any one of us turns on a mobile we all connect to the same infrastructure no matter how rich you are.”

THE RISE OF THE MSMEs

David Hamilton, president of banking technology company Mambu, points out that the base of the pyramid is not just about unbanked individuals, but the opportunity of the approximately 250 million micro, small and medium-sized enterprises (MSMEs) in the world that have little access to credit. He highlights a McKinsey report from 2012 that estimates banks can capture more than $360bn in annual revenue by 2015 through targeting MSMEs in emerging markets.

This ‘missing middle’ of MSMEs – entrepreneurs whose businesses are too large for microcredit but too small to be considered for SME lending – have been targeted by banks such as Brac Bank in Bangladesh and Bank Danamon in Indonesia.

And now it is possible for smaller banks to serve the poor because the cost of technology is coming down. Traditional core banking platforms, says Mr Hamilton, cost hundreds of thousands of dollars and were out of reach for microfinance institutions, which have typically relied on tools such as Microsoft Excel. Mambu is targeting this gap in the market with a cloud-based core banking platform that is cost-effective and is affordable for institutions that may only have 100 customers and one member of staff.

“We are not just moving core banking software to the cloud. We see the cloud as a metaphor for designing the whole business, the pricing, the operating model and culture,” says Mr Hamilton.

BEYOND DEVELOPING MARKETS

Such thinking shows how innovation is coming out of the base of the pyramid and a solution has been developed with this target market in mind.

And now Mambu also has a client using its platform in a developed market. In December 2013, the company signed up My Community Bank, an online-only credit union in the UK, which is seeking to challenge the market that is currently being targeted by payday lenders.

The base of the pyramid does not just apply to emerging markets. “One of the definitions of poverty is that you have less money than you need to survive, whether that is $2 a day in India or $25,000 a year in New York with a family of four. People who are living in poverty cannot buy enough food, clothes or live in proper housing,” says Stephen Vogel, CEO of Grameen America. Grameen America’s mission is to serve those who live below the US federal poverty line.

In an example of reverse innovation, Grameen America uses the micro-lending model that was developed by Muhammad Yunus in Bangladesh. Mr Vogel explains that Grameen America follows Grameen’s original model, of lending to groups of women to finance their own business, with the main difference being the larger maximum first-time loan size of $1500. Unlike Grameen Bank in Bangladesh, Grameen America is not licensed as a bank and so it has partnered with Wells Fargo, Capital One and Citibank so that its customers can open savings accounts at those banks.

“Professor Yunus always said that poor people are the same no matter where they live, and there was absolutely no doubt that [the Grameen model] would be successful in the US, and New York was the first place it was started. We are happy to prove that it does work. The first branch reached sustainability and proved that it is a good model that can sustain itself,” says Mr Vogel, adding that he believes other countries, in Europe for example, have similar characteristics and the Grameen model could work just as effectively there.

As the cost of technology comes down, and digital and mobile payments become widespread, such a vision becomes even more likely. And with new models of financial services emerging from the market that serves the poor, the process of reverse innovation could go one step further and eventually challenge the way that banking is done at the top of the pyramid.