

Making Markets Work Better at the Base of the Pyramid

The recently introduced concept of the "Base of the Pyramid" (BOP) asserts that poor people can be integrated with national and global markets, both as consumers of high-quality goods and services and as producers of reliable inputs to industrial processes and value chains. This bulletin examines the BOP concept, provides examples of how it is already being applied in Viet Nam, and discusses how it can become more effective.

Background

BOP stands for the "Base of the Pyramid." It refers to the 4 billion people who comprise the world's poor (i.e., are at the bottom of the economic pyramid) and to the potential benefits of increased linkages from the base of the pyramid to local and international markets. BOP has increased in popularity as a way of thinking and as a business model since the first major article appeared on this topic in 2002.¹

To date, the main area of interest in and research on BOP internationally has been on its potential as a market for goods and services. However, the BOP theory can just as easily relate to the BOP as a place from which to buy goods and services. On a macro scale, this can be observed in the fact that industrialized countries view less developed countries not only as huge potential markets for goods and services, but also as a source of raw materials and intermediate inputs for industrial production. At the micro level, companies are increasingly producing a range of goods and services that are suitable for lower income consumers in terms of price, availability and product characteristics. At the same time, companies are recognizing the advantages of outsourcing part of their production processes to smaller organizations, including households and producer groups.

In Vietnam, companies are aggressively targeting the rapidly growing number of middle- to high-income urban consumers with expensive electronic products, mobile phones and fashionable clothing. However, it is worth remembering that the vast majority (over 75 percent) of Vietnamese consumers live in rural areas and that their incomes are significantly lower than those of their urban counterparts. As reported in the 2004 Vietnam Household Living Standards Survey (VHLSS), the national poverty rate was 19.5 percent; however, urban poverty was only 3.6 per cent while rural poverty was at 25 percent².

The importance of the BOP

Traditional business models have generally assumed that the poor are not an important market segment, and therefore that they should "make do" with sub-standard products and inefficient

distribution systems. The BOP business model demonstrates that the poor are an extremely important market segment that not only demands but also has the capacity to pay for goods and services that are of a decent standard.

Also, conventional business thinking has assumed that the poor are not an important or realistic part of value chains for higher value commodities, and that therefore they should not be considered potential business partners or sources of supply for industry. The BOP business model shows that if businesses are willing to work together with small-scale, poor suppliers to overcome the difficulties of availability, affordability and access, then the poor can be effective links in the value chain.

Traditional development models have assumed that the interest of businesses (and, in particular, of big business) and the interests of poor consumers and producers are generally not aligned. The BOP model shows that as businesses recognize the poor's potential as producers and consumers, the market mechanism can deliver effective development results directly to the poor.

Selling to the BOP

The concept of developing a business strategy to provide goods and services to consumers at the base of the pyramid is based on a number of key ideas. Firstly, while poor consumers have a lower level of disposable income than higher-income consumers, they still represent a consumer group who are prepared to pay a reasonable price for the goods and services that they require, as long as those goods and services are delivered in a suitable form.

Secondly, consumers at the base of the pyramid are brand-conscious and well-connected to information sources and networks that enable them to be as discerning a consumer group as those at the top of the economic pyramid. In some cases, especially when it comes to daily necessities, BOP consumers may actually be more discriminating, as their expenditures on these necessities occupy a far higher proportion of their incomes than is the case for wealthier consumers.

Finally (and in many ways, most importantly for the base of the pyramid business model), while the relatively lower prices for products targeted towards the BOP market mean that the profit margin for each product is generally smaller than the margin on a product targeted towards a wealthier market segment, the massive size of the BOP market means that the overall potential profit for companies is large. In other words, targeting the BOP is a business strategy that uses increased sales volumes to compensate for reduced per-sale margins.

The key to successfully targeting the market at the base of the pyramid is to "create the capacity to consume" - in other words, to ensure that poor consumers are able and willing to purchase the goods or services provided by companies. The method of ensuring that the poor are able to consume products has been described by Prahalad and Hart as the "Three A's":³

Affordability. Goods and services that target the BOP market should be affordable. BOP consumers have lower disposable incomes than consumers higher up in the pyramid, and so product affordability is a key concern for them. In order to improve affordability without reducing quality, companies have adopted several strategies, including creating smaller packaging sizes (such as single-serve shampoo sachets), using generic branding, and developing innovations in purchasing schemes.

Access. Distribution patterns for products and services must take into account both where the poor live as well as their work patterns. Most BOP consumers must

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¹ C. K. Prahalad and Stuart Hart, "The Fortune at the Bottom of the Pyramid," *Strategy + Business*, Issue 26, 2002.

² GSO (2004), "Viet Nam Household Living Standards Survey", General Statistics Office, Ha Noi, Viet Nam. The statistics is based on old poverty line. According to the Press Release of GSO on 20/7/2005, the poverty rate in 200 which is based on new national poverty line for 2006 - 2010 (VND 200,000/person/year in rural areas and VND 260,000/person/year in urban areas) is 18.1 percent for the whole country, 8.6 percent in urban areas and 21.2 percent in rural areas.

³ These are also discussed extensively in Market and Development Bulletin No. 9 "Collective Action" which is available at www.markets4poor.org.

work the full day before they have enough cash to purchase what they need for that day. Access to goods and services for these consumers means that they should be able to make purchases at convenient times and in locations close to where they live and work.

Availability. According to Prahalad and Hart, BOP consumers' purchasing decisions is often based on the amount of cash they have on hand at a given point in time; they cannot defer buying decisions. Therefore, product availability is a critical factor in serving the BOP consumer.

Examples from Vietnam

While companies have produced goods and services aimed towards the BOP market in Vietnam for a number of years, these have traditionally been of very low quality and have been inefficiently distributed. Products with higher quality have generally targeted towards a more affluent market.

However, in recent years, a number of companies have started to produce high quality goods and services that target the very large BOP market in Vietnam. These include: soaps, shampoos and tooth-pastes in individual sachet sizes; low-cost personal computers; pre-paid mobile telephone cards in small denominations; and insurance products designed for lower income consumers.

While international companies such as Procter & Gamble and Unilever have been at the forefront of targeting the BOP market in Vietnam, local companies are increasingly viewing the base of the pyramid as an attractive market and are designing products and distribution systems to increase product affordability, availability and access. For example, Lix detergent powder is distributed through a network of small-scale distributors and retailers (increasing access and availability), and is sold in small packet sizes (to improve affordability).

Although marketing expenses and packaging generally comprise a large proportion of product costs, many Vietnamese products (e.g., dried herbs and mushrooms) targeted at the BOP market have relatively low cost and localized packaging structures promotional activities (e.g., local specialities such as coconut candy in Ben Tre).

Buying from the BOP

The underlying themes of the BOP concept can be modified to include the base of the pyramid as a market from which to buy goods and services, as well as just a market to which goods and services can be sold. Likewise, the "Three A's", can also be applied to their ability to participate as suppliers.

Affordability. Those at the base of the pyramid are often at a disadvantage as suppliers of goods and services because poor economies of scale and low quality infrastructure prevent them from competing with other suppliers on price. However, by working together rather than individually, they can make productivity to gain and reduce unit costs.

Access. Access to higher value markets for poor producers is often limited due to geographical factors and the relatively low quality and undifferentiated nature of the goods and services that they (poor producers) supply. In countries like Vietnam, rural poverty is highly correlated with geographical isolation. The added time and difficulty associated with the transport and supply of goods and services from relatively remote areas makes it more difficult to participate in higher value markets.

Availability. In addition to providing affordable and easily accessible goods and services, another prerequisite for linking effectively to value chains is that products and services must be of consistent quality, obtainable in a timely manner, and available in the quantities required. However, the lack of certainty in demand and low levels of working capital often result in poor producers being unable to guarantee the reliable supply of goods and services required by other actors in the value chain.

Examples from Vietnam

Compared to the concept of selling to the base of the pyramid, the concept of using the poor to supply inputs to industrial processes has attracted more attention from policymakers in Vietnam, including many policies rural development policies. This is particularly the case for many agricultural products. Due to the history of land distribution in Vietnam, there are very few large-scale farms in the country. Instead, the agricultural sector is dominated by a large number of small scale household producers. As a result, in order to develop value chains for agricultural products (for both the export and domestic markets), actors in the value chain have had to link with small-scale, poor producers of agricultural raw materials.

It is important to not only increase the poor's ability to act as input suppliers but also to ensure that their participation in the value chain benefits them. In order to increase participation of the poor in value chains in Vietnam and to empower them as suppliers, the Ministry of Agriculture and Rural Development (MARD) has promoted contract farming. Government Decision 80 on contract farming, the Cooperative Law and the draft Law on Associations all encourage a well-organized system that links suppliers at the base of the pyramid with markets. This has been effective in the case of specialized products such as Japanese rice and baby corn. Although the success of contracts for more general commodities has been lower, there are still some notable exceptions, such as that of the Lam Son Sugar Company in Thanh Hoa, which has developed an effective and harmonious relationship between poor producers and the rest of the value chains.⁴

Recommendations

There are two main actions that policymakers can undertake to encourage and maintain the positive development of BOP models in Vietnam. These are (i) recognizing the importance

of quality, and (ii) developing effective models of market linkages.

Recognizing the importance of quality. Consumers at the base of the pyramid have increasing access to various sources of information, such as radio, television, newspapers, internet, social networks, etc. As distribution networks improve, the poor also have a greater range of product choices open to them. These factors mean that the poor are also increasingly demanding higher quality products. Similarly, as the poor aim to integrate into value chains and become suppliers to industry, the issue of quality is paramount. It will be impossible for the poor to compete with larger scale producers, whether in Vietnam or overseas, without maintaining high product quality. The poor's ability to compete on the basis of quality will be even more important as the economy integrates further into the world markets.

In order to promote quality, there is an urgent need to develop a set of credible and enforceable standards for goods and services. These standards should reflect the actual situation in Vietnam and their application should be feasible in the local context. Such standards could be developed by the government (as is the case with standards for products like rubber) or by non-governmental bodies (such as the certificate of origin standards and labeling for Phu Quoc Fish Sauce⁵). In addition, the government should strongly enforce intellectual property rights (IPR) legislation so as to increase general confidence in the quality and authenticity of products and services.

Developing effective models of market linkages: It includes improving the system of contract farming in order to effectively link farmer groups as part of an increasingly commercialized agriculture sector. In addition, improving coliteivation (such as improved models for cooperatives or farmer groups) is also a way of increasing the effectiveness of market linkages for producer groups.

Effective models of market linkage should also include higher levels of trust between participants that those which currently exist. Building trust between levels of the value chain means that each party to a linkage must trust that the other parties will honor agreements made. In the case of contract farming, this means that processors must trust that farmers will supply goods at the prices and specifications indicated in the contract. Conversely, farmers must have a level of trust that processor will honor their commitments under the contract.

In the area of linking the poor to value chains, the ongoing evaluation and revision of Decision 80 on contract farming should take these factors into account and should explicitly include measures⁶ designed to promote the building of trust-based linkages.

⁴ See more details in Market of Market and Development Bulletin No.2 "Linking Farmers to Markets through Contract Farming" which is now available at www.markets4poor.org.

⁵ Labels and standards developed by government and also by producer associations and other bodies are discussed more extensively in Market and development Bulletin No. 4 on Pro-Poor Branding, Labeling and Trademarks for Agricultural Products available at www.markets4poor.org

⁶ These measures are also discussed in details in Market and Development Bulletin No. 2 on Linking farmers to markets through contract Farming, available now at www.markets4poor.org

Talking Heads

Selling at the BOP



Market research by CMS showed that there is a huge potential at the BOP market in Vietnam. Therefore, our company has decided to penetrate into this market with the Thanh Giong Computer introduced in 2004 with price ranges from VND5.5 million to VND 6 million/unit, and the low-price laptop program introduced in 2006 with unit price below VND10 million. These products targeted at customers such as pupils, students, teachers etc. and are distributed via a nation-wide distribution system. Formerly the volume purchased by this consumer group was low, but just one year after the program, turnover gained from this group has increased and accounted for 10% of our total turnover. We coordinated with other established partners such as Intel, Microsoft etc. to reduce the production cost while maintaining the quality at a standard equivalent to that of other similar well-known products such as Acer, HP, Toshiba ... Consumers can access to our products and enjoy our after-sale services best through our nationwide distribution and warranty system. Together with the Thanh Giong program, the low-price laptop program is considered quite successful with products not enough to meet the demand. However we also faced many difficulties due to low profit margin in comparison with huge cost incurred. At this initial stage, our company focuses on the break-through, establishment and maintaining the competitiveness of our trademark.

Mr. Le Quoc Thai, Head of Communication Group No. 2, CMS



The poor tend to have little financial security against difficulties that they may face. They normally save for themselves and their families, rely on relatives and friends, and do not come to health-care centers reglადue to financial difficulties. They rarely use the financial services (in fact these services are also limited), therefore, we introduced two life insurance products namely Phuoc An Gia and Phuoc An Binh, targeting at the middle and low-income earners. For these groups, these insurance products have low premium, which is only one lump sum payment of VND2.5 million (minimum) and annual installments of VND26,000. In case of risks, the customers will enjoy compensation up to VND100 million. In addition, savings interest rates are committed at 7.1% is also very attractive as compared to that of other life insurance products in the market. Prevoir products are introduced via the post-office systems, serving 7

days a week and 24 hours a day, with simple procedures and waiver of health-check certificate (only 6 questions on health condition). All these procedures are carried out at the local post offices.

Mr. Doan Ba Tuoc, Sales and Marketing Manager, Prévoir Vietnam Life Insurance Company Limited

We are well aware that BOP consists of those who have income and demand for products, and who reside all over the country and not necessarily in rural areas. In urban cities, consumers often choose products to meet their self-recognition demand, while in rural areas they tend to choose the basic products and balance between the family's and their self demand. Consumers in rural areas usually purchase from traditional distribution channels, therefore, it is impossible to introduce products to them unless they are sold at accessible outlets such as traditional markets, groceries. In addition, these people tend to limit their spending and consider the price carefully. Researches show that 9 out of 10 consumers calculate the price based on product unit.

When building the business program, we focus on its long-term operations with due consideration to our financial capacity as distributing goods at remote areas would incur high distribution costs. In addition, we attach special importance to our business partners, marketing and media channels for purpose of socialization and making the best use of resources. We would also maximize our distribution system to outreach the small towns and provinces, as well as try out unceasing efforts to reduce costs, reduce prices while maintaining quality. Enterprises may take innovative measures in packing process, for example: Downy softener is packed in plastic bags then it can be poured into bottles. This would save production cost as well as reduce product price. It would also be necessary to have clear-cut separated stages of activities, as it impossible to penetrate immediately into all remote areas. The initial targets should be big cities, after that is level 2 and level 3 cities, and then other more remote areas.

In our marketing and promotion programs, P&G focuses on the value of each brand name. Each product has its own value, for example Pantene is for smooth and shinning hairs. Head&Shoulder for dandruff treatment etc. In addition, the consumers should be equipped with adequate information about the product, expiry date and frequency of usage. They are also interested in promotion programs such as 1 free for 10 purchases. Enterprises can also coordinate with art units to organize cultural events, innovative marketing programs in order to introduce the products to consumers.

Mr. Vu Van Thang, Financial and Public Relation Manager, P&G Vietnam

Buying from the BOP

Ecolink chooseto produce and distribute organic tea products, which is a breakthrough into the market. These products are tea leaves cultivated and processed organically without any chemicals. For a country whose tea production ranks the 8th in the World and with 6 million people depending on tea production like Vietnam, using organic tea is also helping poor farmers. Presently, we are investingin some special tea growing areas such as Tan Cuong (Thai Nguyen Province), Suoi Giang - Suoi Bu (Yen Bai Province), Bac Ha (Lao Cai Province) in order to have a professional production process with high quality products. We are also working with smallholder farmers to produce a variety of products such as organic green tea, lotus scented, jasmine scented tea and black tea. Now our products have been exported and are available for sale in Germany, Italy, France, Belgium and the United States as well as in a number of hotels and restaurants in Vietnam including the Metropole.

Ms. Nguyen Bich Hanh, Executive Director, Ecolink Company

IKEA has cooperated with Making Markets Work Better for the Poor Project in a project to develop the bamboo raw material supply chain in Thanh Hoa which aims to correct the shortfalls in the market and the bamboo supply chain. We have assisted pre-processing workshops piloting with farmer groups/ farmer entrepreneurs to increase value added to farmers in the bamboo supply chain. The concept of pre-processing workshops involves cutting and splitting the bamboo culms on site, optimizing the usage of material for more value added. After a period of implementation, the results are very promising with job creation for about 540 workers, about 3,000 - 5,000 households estimated to be directly related to the projects, increase in the farmers's selling power, and secured high quality raw materials for suppliers.

Apart from the case with Thanh Hoa bamboo supply chain, IKEA also works with BOP markets in other fields such as ceramics, natural fibres and textiles.

Mr. Mikael Demitz-Helin, Trading Area Manager for South East Asia, IKEA

The importance of the BOP

I feel very anxious when listening to opinions of some established corporations such as Canon, LG-Vietnam, BP Vietnam, Unilever. They are very interested in the BOP market segment in Vietnam, while our local enterprises do not show much interest. Vietnamese enterprises are used to caring about the poor as a "social responsibility" - like a charity activity instead of a market segment. In fact, the BOP market in Vietnam is rela-



tivel large, with the poverty rate decreasing sharply from 58.1% in 1993 to 19.5% in 2004 out of the total population of 85 million. Poverty line is also being adjusted upwards, equivalent to international standard of USD2/per day.

Dr. Pham Thi Thu Hang, Director of Enterprise Development Institute, Vietnam Chamber of Commerce and Industry (VCCI)



In Vietnam now, there are about 50,000 workers directly involved in producing IKEA products and additional 180,000 indirect workers. Currently IKEA has 43 suppliers in Vietnam who deliproductsequaling 620.000 m3 of goods per year. The areas of work we carry out in Vietnam (ceramics, natural fibers, wood, textile ...) are all based on the rich, available experiences and low labor cost of Vietnam in these fields, what we do is just bringing more industrialization. Infact, there is no contradiction between companies doing business and making social contribution, they can earn money and contribute to the community at the same time.

Mr. Mikael Demitz-Helin, Trading Area Manager for South East Asia, IKEA

P&G has only been focusing on the BOP market during some recent years. Our business results achieved at the BOP market is very positive with more than 50% of the company's turnover and business activities carried out in areas other than main cities. 90% of the strategic brand names are distributed via the key distribution channel nationwide though we have only 14 distributors.

Mr. Vu Van Thang, Financial and Public Relation Manager, P&G Vietnam

The BOP with 4 billion poorest people in the world presents unique challenges to development practitioners, governments, and the individuals and firms in the BOP. With the right preparations, multi-national companies (MNCs) can grow their businesses by selling into this huge market. MNCs can also try to create value and help people at BOP increase their wealth by sourcing from BOP firms or localizing supply chain operations, bringing BOP firms into the global marketplace. BOP firms also need to realize that they are working in the BOP market themselves! When asked what their main goal is, many small and medium enterprises in



developing country say "export", they often forget that they are in a growing market that has unmet demands and needs, and they are often best positioned to take advantage of that marketplace.

Development practitioners and MNCs can make great strides at alleviating poverty at the BOP when they collaborate and cooperate to make the most of this huge, and growing, market.

James Grall, Principal, Development Alternatives Inc.

Recommendations

In order to help low-income earners become potential consumers or suppliers, it is necessary to have a broad propaganda program. Some large corporations in Vietnam have not managed to recognize the huge potentials and profits of this BOP market segment. In other words, their development strategies pay little attention to this market segment. It is regrettable. On the other hand, to help low-income earners become high quality goods/service suppliers for the enterprises, there should be suitable supporting policies for small and micro enterprises, via training assistance, improving quality, building trademark etc. These could help the poor have positions in the value chain and also be the best way to ensure that they can have sustainable market accessibility.

Dr. Pham Thi Thu Hang, Director of Enterprise Development Institute, VCCI

We ensure the product quality and quantity by helping farmers to really understand the quality demand and what customers really expect. One possible way is that we can provide them with physical sample with specific assessment so that they have a sense of what is required. If the quality of the product does not meet agreed level, the product will be claimed and consequently sent back to the producer. This can become very costly as the farmer has to buy back the product and also pay for transportation. Besides, in order to secure the understanding we translate all the contracts and documents into Vietnamese and help the producers fully understand what is required. We should ensure that they are all informed and have understood beforehand.

Mr. Mikael Demitz-Helin, Trading Area Manager for South East Asia, IKEA

High quality products require qualified farmers, workers and a close coo-

peration among production, industrialization and consumption. In order to maintain sufficient supplies, we have organized farmers into business and production groups, for example the Organic Tea Preference Group, the Organic Tea Cooperative. In addition, we also provided consultation and helped build up the management apparatus for the groups/cooperatives, provided training for the farmer coaches, management officials and helped establish the trademark for each specialized product. Ecolink also applies the Fair Trade principles, giving farmer groups respect as partners in long lasting and mutual benefit cooperation.

Ms. Nguyen Bich Hanh, Executive Director, Ecolink Company

At present, our market share at the BOP is still low. We hope that once the Government bans the import of second-hand computers, consumers' awareness of trademark is improved and product price is reduced, the number of consumers will increase. In addition, the most challenging task is changing the consumers' view and thinking about Vietnamese-made computers. We are actively coordinating with our agents in the distribution system, offerg promotions, using mass-media to introduce our products to consumers.

Mr. Le Quoc Thai, Head of Communication Group No. 2, CMS

Small producers and small market players have their own positions and they are quite successful, like the case of My Hao dishwasher or Vi Dan detergent. In comparison to Unilever, My Hao is very small and they do not invest much in advertisement, however My Hao dishwasher is very successful with a market share of 52%. Therefore, it doesn't matter whether you are big or small, what the matter is having a suitable business model. In the case of Vi Dan detergent in the North, their production activities are very simple, they even pack their detergent in large jut bags and transport their products to retailers... but they are doing very well. This indicates the role of the strategy and the detailed activities within such strategy. All the small players have the right to triumph, provided that they know their customers well, understand their business strategy and have an appropriate process of building up the company strategy.

Mr. Vu Van Thang, Financial and Public Relation Manager, P&G Vietnam