

# **THE BASE-OF-THE-PYRAMID PERSPECTIVE: A NEW APPROACH TO POVERTY ALLEVIATION**

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## **ABSTRACT**

While interest in the base of the pyramid (BoP) is growing, exploration of the unique poverty alleviation implications of a BoP perspective has lagged. The purpose of this paper is to put forth a set of principles that distinguish the BoP perspective from other poverty alleviation approaches.

## **INTRODUCTION**

The base (or bottom)-of-the-pyramid is a term that represents the population of the world that primarily lives and transacts in an informal market economy. Since its initial articulation (Prahalad & Hammond, 2002; Prahalad & Hart, 2002), a growing number of authors and researchers are using the term BoP in their writings. Interest in supporting the development of BoP ventures is also occurring in the field. These ideas are crossing sectors, as organizations in the private, non-profit, and development communities are interested in applying BoP ideas to their new initiatives (Gardetti, 2007).

While much debate and most of the writings on this perspective have centered around who is in the BoP (Hammond, Kramer, Katz, Tran, & Walker, 2007) and how BoP ventures need fundamentally new market entry strategies (Hart, 2005; Hart & London, 2005), a deep exploration of the poverty alleviation implications has lagged (London, 2007b). What has not been fully articulated is how this perspective differs from other market-based poverty alleviation approaches, and thus, how its poverty alleviation outcomes may be different. Indeed, to give credence to the BoP perspective's claim of having unique poverty alleviation implications, we must explore the key principles of this perspective and understand how they differ from other market-based poverty reduction efforts (Walsh, Kress, & Beyerchen, 2005).

## **A BOP PERSPECTIVE ON POVERTY ALLEVIATION**

At its core, the BoP perspective relies on a hypothesis of mutual value creation; the greater the value created for those living at the BoP, the greater the value created for the venture. Indeed, BoP ventures are expected to generate acceptable economic and societal returns to the organization investing in the venture and the local community in which they operate (Hart & Milstein, 2003; London & Hart, 2004; Wheeler et al., 2005). Clearly, this hypothesis, if supported, has implications for both business strategy and poverty alleviation.

A BoP venture is a revenue generating enterprise that either sells goods to, or sources products from, those at the base of the pyramid in a way that helps to improve the standard of living of the poor (Prahalad & Hammond, 2002; Prahalad & Hart, 2002). These two orientations

can be termed “BoP as consumer” and “BoP as producer,” respectively (Rangan et al., 2007), and a specific BoP venture can adopt either, or both, approaches (Anupindi & Sivakumar, 2007). While BoP-as-consumer and BoP-as-producer ventures are likely to have different poverty alleviation outcomes (Leonard, 2007), they are based on the same core principles.

As a poverty alleviation approach, the BoP perspective relies on the view that serving markets at the BoP is an economically viable business strategy (Prahalad & Hammond, 2002; Prahalad & Hart, 2002). As such, this market-based perspective differs from grant-based poverty alleviation programs, as the goods and services provided by the venture are not free of cost. This does not preclude those at the BoP from receiving a subsidy to purchase from or sell to a venture. The BoP venture, however, must generate sufficient revenues to more than cover its costs.

Still, market-based approaches to poverty alleviation are not new. Micro-finance initiatives have provided modest-sized loans to small local businesses for several decades (Chu, 2007; Yunus, 1999). Aid agency programs providing managerial and technical assistance to micro-, small- and medium-scale enterprises have been a hallmark of development assistance for many years. More recently, value chain initiatives have emphasized raising the competitiveness of entire industries, and enabling environment programs have targeted policy reforms to transition informal market activities to a more “Western” legal and regulatory business environment within a specific country.

Given these existing approaches, it is important to articulate the unique insights that the BoP perspective offers on poverty alleviation. Some have suggested that the BoP perspective is based on large companies selling smaller sizes or easier-to-afford versions of their existing products to respond to the limited purchasing power and investment capabilities of those at the BoP (Karnani, 2007; Wilson & Wilson, 2006). If this approach is really no more than multinational corporations (MNCs) offering incrementally modified versions of current Western-oriented products, then a BoP perspective may, at best, make a modest contribution to our thinking about market-based approaches to poverty alleviation.

A more comprehensive examination of the current body of work, however, suggests that the BoP perspective presents a more nuanced argument. Existing research on the BoP perspective indicates that there are six principles that, when combined, separate it from other poverty alleviation approaches.

### **Principle of External Participation**

The BoP perspective requires the entry of an exogenous, or external, venture or entrepreneur into the informal economy where the poor live and operate. External participation can come from a variety of sources, including MNCs, domestic firms, and non-profit organizations as well as non-native individuals who catalyze the development of new enterprises or cooperatives. Researchers have argued and empirically shown that entry into BoP markets by non-native organizations requires the development of a new capability (Hart, 2005; Hart & London, 2005; London & Hart, 2004; Sanchez, Ricart, & Rodriguez, 2007). This new capacity is termed “social embeddedness” or “native capability” and is defined by London and Hart (2004: 164) as “the ability to create a web of trusted connections with a diversity of organizations and institutions, generate bottom up development, and understand, leverage, and build on the existing social infrastructure.”

Two points are critical to understanding external participation and the term “non-native.” First, being native to a country does not necessarily make one native to the BoP; host-country nationals ought not to automatically assume they are familiar with the BoP. Second, being native in one place does not always translate to another location. Some expertise, knowledge and experience likely are transferable, but others are probably not. Organizations should not assume that a business model successfully implemented in one BoP community automatically transfers to another.

One implication of the principle of external participation is that it distinguishes the BoP perspective from micro-finance and micro-enterprise development programs. A BoP perspective involves external ventures or entrepreneurs entering BoP markets. Most micro-finance and micro-enterprise development initiatives, on the other hand, target their support toward businesses or business start-ups developed solely by those at the BoP. They primarily promote local business ideas that already exist and, as such, do not focus on encouraging external participation.

### **Principle of Co-Creation**

While external participation is required to catalyze the development of BoP ventures, local co-invention and bottom-up development are key components of the BoP mantra for success (London & Hart, 2004). This allows these ventures to combine knowledge developed at the top of the pyramid with the wisdom and expertise found at the bottom in a way that enables co-discovery of new opportunities to serve those at the BoP (Whitney & Kelkar, 2004). Rather than relying on imported solutions from the developed world, the business model of the BoP venture and any associated technological solution is co-created among a diversity of partners, with local ownership and involvement seen as crucial to success (Hart & Sharma, 2004).

The principle of co-creation distinguishes the BoP perspective from typical corporate and development strategies that rely on importing pre-existing approaches and technologies into BoP markets. When firms enter new markets containing familiar consumers, adapting current products and models works well. As they move down the economic pyramid, however, these companies must proactively avoid importing pre-existing mindsets and models (Prahalad & Lieberthal, 1998).

As Chambers (1983; 1997) has indicated, most traditional poverty alleviation programs also often rely on a top-down approach. Indeed, professionals trained in the developed world typically design and manage these poverty alleviation initiatives. The BoP perspective suggests that development efforts would benefit from a reversal in learning. Only through a process of co-creation can a BoP venture truly hear and respond to the voices at the BoP.

### **Principle of Connecting Local with Non-Local**

BoP ventures connect those at the BoP to markets they did not previously have access to, by either bringing non-locally produced products to BoP markets, or by taking BoP-produced goods or services to non-local markets (Rangan et al., 2007). For BoP-as-consumer ventures, this means providing goods and services not currently offered in local markets. For BoP-as-producer ventures, this requires taking locally-produced goods and selling them in non-local markets, including both wealthier in-country and international markets (Arnould & Mohr, 2005). A BoP venture can also take a locally produced good, such as honey, and sell this product to BoP

markets in other (non-local) regions or countries. In this case, the venture combines both BoP-as-producer and BoP-as-consumer components.

One implication from the principle of connecting local to non-local is that ventures based solely on having employment relationships with those at the base of the pyramid are not BoP ventures. In this case, no locally produced goods or services (other than labor) are transferred from local to non-local markets. As such, building a factory at the BoP or hiring someone from the BoP to work in a larger city, in and of itself, does not qualify as a BoP venture.

### **Principle of Patient Innovation**

An important theme in the BoP literature is the need for innovation (Christensen, Craig, & Hart, 2001; Hart & Christensen, 2002; Prahalad, 2006). This has both time and financial implications. In terms of a time commitment, establishing a venture requires the sponsoring organization to have a long-term orientation on developing the business model. Similar to investments in technology-based research and development (R&D), BoP ventures view business model creation as an innovative process that will take time to come to fruition (London, 2007a).

Furthermore, conducting this business model R&D requires careful reconsideration of the routines and processes that organizations traditionally use to understand, evaluate, and explore new opportunities (Milstein, Hart, & London, 2007). This process takes time, as managers must overcome existing biases about the poor and the ways in which their organizations can serve them. Firms attempting to enter these markets must develop new problem-solving approaches, rely on different evaluation metrics, and find a structure that provides some level of isolation from the influence of existing organizational routines.

The BoP perspective also emphasizes the need for patient capital. Financial commitments are best viewed as investments that start small and are then potentially scalable (Simanis & Hart, 2006). As in any area of new business development, not all new BoP ventures will be successful. The successful ones are expanded by committing additional resources and the unsuccessful ones are stopped or redirected (London, 2005).

Due to their short-term funding approach, typical development initiatives, however, rarely have much opportunity for the experimentation and trial-and-error that is inherent in an R&D process. These initiatives are often expected to be fully operational within a year or so and to aggressively scale up shortly thereafter. Indeed, a key metric for many development initiatives is how fast the money is spent (Easterly, 2005). The BoP perspective, alternatively, emphasizes a more incremental, or real options, approach to investing resources.

### **Principle of Self-Financed Growth**

The key to growth and scalability of BoP ventures is profitability associated with competitive advantage. The BoP perspective relies on the view that unmet societal needs are also potential business opportunities (London & Hart, 2004; Prahalad, 2004; Prahalad & Hart, 2002). BoP ventures operate under a hypothesis of mutual value creation; the greater the ability of the venture to meet the needs of the poor, the greater the return to the partners involved. Competitive advantage and the associated long term sustainability of the venture will most likely emerge from establishing a set of mutually beneficial partnerships with local organizations and entrepreneurs currently operating at the BoP (Brugmann & Prahalad, 2007; Hart & Sharma, 2004; London & Rondinelli, 2003; Sharma et al., 1994).

An important implication of the principle of self-financed growth is that the BoP perspective does not focus on raising the overall playing field in an industry. Rather it emphasizes competitive advantage and maximizing the benefits accruing to the BoP venture and its partners. This is a different approach than is found in value chain initiatives, which target enhancing the viability of all players within a specific sector.

### **Principle of Focusing on What Is “Right” at the BoP**

The BoP perspective emphasizes that there is an intrinsic economic rationale to the informal sector, and that organizations wanting to serve the poor should learn from, and adapt their business models to this sector (London & Hart, 2004). This means that the BoP venture, be it a for-profit business or a non-profit initiative, ought to focus on leveraging what is “right” in BoP markets. For example, a number of initiatives serving the poor rely on existing self-help groups, and the associated social capital within these organizations, as a way to distribute their products.

Rather than imposing “Western” business approaches and looking to move local business activity from the informal to the formal economy, a BoP venture crafts a strategy that relies on the existing resources, expertise, and social infrastructure already present in the informal market (Hart & London, 2005). This may also mean that the venture must invest in local capacity building, such as educational awareness or skill building, which is outside of organizational boundaries.

An important implication of the principle of focusing on what is “right” at the BoP is that the BoP perspective enhances what already exists and builds from the bottom-up. This distinguishes it from poverty alleviation approaches emphasizing the development of an enabling environment. These latter efforts are more policy oriented and stress the benefits of moving informal business activities to the formal economy (de Soto, 2000).

### **BoP Ventures**

Together the six principles of the BoP perspective – external participation, co-creation, connecting local with non-local, patient innovation, self-financed growth, and focusing on what is “right” at the BoP – provide insight into who is involved in a BoP venture, the intermediary role the venture plays, how the venture views the local environment, and the approach the venture takes to scale its impact. As a BoP venture can view those at the BoP as consumers or as producers, combining these six principles leads to the following two definitions:

**BoP-as-consumer ventures** are scalable profit-oriented ventures operating in the informal economy, catalyzed by external participation and co-created with those at the BoP, that connect non-local goods and services to BoP markets.

**BoP-as-producer ventures** are scalable profit-oriented ventures operating in the informal economy, catalyzed by external participation and co-created with those at the BoP, that connect BoP producers of goods and services to non-local markets.

## **FINAL THOUGHTS**

Poverty, especially in developing countries, is one of the world’s most intractable problems. While this remains a daunting challenge, it is not an excuse for inaction or

unwillingness to explore new approaches. Donation-based aid programs can make an important impact on alleviating poverty, but they are inherently not economically sustainable. Once implemented in a specific community or region, there is no capital remaining to transfer the program to another location. Market-based approaches offer an attractive alternative, as they can be economically sustainable. While a number of interesting approaches have been developed over the years, they too have limitations in their effectiveness and their scalability to new locations. This suggests an opportunity to identify new poverty alleviation approaches based on market mechanisms; the BoP perspective is one such approach.

In the BoP perspective, profits and the associated ability to generate self-financed growth are the prime drivers of poverty alleviation, and the societal returns for any capital invested are subject to the economic performance generated by the business. Indeed, the hypothesis is that profits and poverty alleviation can be synergistic; a long-term orientation supported by continual access to self-generated financial resources allows BoP ventures to scale business models that have net positive poverty alleviation implications.

While creating and implementing BoP ventures involves external parties that are non-native to the BoP, active participation of those at the BoP in venture design is also critical. Long-term venture success relies on capturing value for all of its partners. Without viable local partnerships, ventures will have difficulty generating sustainable competitive advantage and are unlikely to achieve financial viability.

Finally, these ventures focus on finding what is “right” at the BoP. Rather than worrying about the perceived limitations of the informal economy, the BoP perspective emphasizes bridging the formal and informal by leveraging the strengths of the BoP and combining that with expertise developed at the top of the pyramid. For the development community, a collaborative effort among equals focused on generating profitable ventures offers new insights into a market-based approach to poverty alleviation.

#### **REFERENCES AVAILABLE FROM THE AUTHOR**

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