



WOODWARD
FELLOWS

BOP SERIES: VOL. 1

NOVEMBER 2007

MANAGEMENT BRIEFING

The Base of the Pyramid – Fortune or Mirage?

As value chains stretch across the globe, the impact of firms' investments on the poor are under increasing scrutiny. A great deal of hype surrounds new ideas about how to make money by selling to the "base of the pyramid". However, Prof. Aneel Karnani of the Ross School of Business at the University of Michigan critiques the idea that selling to the poor is an effective method of poverty alleviation.

Globalization has brought many people into the global economy. Low cost labor pools along with enabling communication technology and falling transport costs has caused the business community to stretch value chains across the globe, and trade in intermediate goods has grown dramatically over the past few decades. But, globalization has distributed its benefits unequally. While there are 600 million people with incomes exceeding \$20,000 annually, over 4 billion people earn less than \$3,000 annually. The base is largely rural, under served and, in many cases, not part of any organized economic sector.

For generations, the role of poverty alleviation has been a focus of solely governments and the nonprofit development community – \$260 billion in aid has been spent on poverty alleviation over the past 60 years. Recently, however, there has been a surge of interest in the Base of the Pyramid (BoP) among the business community. Inspired by high profile cases of companies which have earned profits by creatively selling to the base of the pyramid, a growing chorus has called for business to help the poor by viewing them not as victims, but as consumers.

To supporters, BoP initiatives offer a new market based approach to alleviating poverty. One of the central tenets of the BoP approach is its focus on generating profits while lifting people out of poverty. Introduced in 2002 by C.K. Prahalad of the University of Michigan and Stuart L. Hart of Cornell University, the BoP perspective has gained a great deal of attention with its promise of unleashing new private sector investment that simultaneously generates returns while lifting millions out of poverty. Since its inception,



Featuring

Professor Aneel Karnani is faculty member of Corporate Strategy and International Business at the Stephen M. Ross School of Business, University of Michigan. Prior to joining the University of Michigan's faculty in 1980, he obtained his doctoral degree from the Harvard Business School. He also holds an MBA and B.Tech. (Electrical Engineering), both from India.

the focus of BoP has been on how business can serve the poor by selling to the base of the pyramid. Prahalad's book, *The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits*, became a best seller outlining a vision based on the BOP market "as a major engine of growth and global trade."

Still, recent critiques question the notion that the poor can be lifted out of poverty by treating them as consumers. Among the critics is Aneel Karnani. As Associate Professor and Chair of Strategy at the University of Michigan's Ross Business School, Dr. Karnani is interested in global competition, particularly in the context of emerging

A growing chorus has called for business to help the poor by viewing them not as victims, but as consumers.

economies. He wants to determine how local companies can compete against large multinational firms, and how multinational firms can succeed in these unfamiliar markets. Along these lines, Karnani also researches the role of the private sector in poverty reduction. Woodward Fellows recently sat down with Dr. Karnani to discuss his views on the role of the private sector in emerging economies. Their conversation examined ways multinational corporations can spur development and reduce poverty in emerging economies.

Limitations of Selling to BoP

While the bottom billion of the poor are located in failed states, the next three billion people are better off because they are living in regions where resources are available. Although Karnani agrees that determining how to best use these resources is complicated, he is certain that selling to BoP is not the solution: “[Selling to the poor to improve their condition] is very seductive because it tells business that you can get rich and help the poor all at the same time, that you can be a saint and rich simultaneously. But you cannot make the poor better off by trying to sell more to the poor... The poor don’t benefit from this strategy and actually there is a potential to exploit them because the company is trying to sell them stuff that they don’t need



or is bad for them.” Karnani also points out that firms should not sell to BoP because there is no profitability. In fact, most multinational firms have already dismissed BoP and started targeting the emerging middle classes.

Limitations of Microfinance

In addition to BoP, microfinance is another strategy aimed at reducing poverty. Karnani agrees that from a poverty perspective, microfinance is better than BoP because it buys from the poor instead of selling to them. But while microfinance has non-economic benefits, especially for women, Karnani argues that the supposed economic benefits have not been proved. Simply stated, the arguments supporting microfinance are basically a matter of emotion and not sound economic strategy. “Microfinance doesn’t work because the idea of microfinance is that all these poor people will become entrepreneurs. Most rich people don’t become entrepreneurs,” Karnani said. “To

be an entrepreneur, you’ve got to have some idea of business, some creativity, some vision or some persistence, some drive, and so on... Even most of the rich people in a rich country don’t become entrepreneurs. They get a job

“Microfinance assumes that all these poor people will become entrepreneurs. Most rich people don’t become entrepreneurs”.

with a company or do something else, but they earn a salary rather than becoming self-employed entrepreneurs. So this idea that we can give a couple of hundred dollars to every poor person and make them into entrepreneurs is a romanticized view of the poor.”

Reducing Poverty through Job Creation

So what can be done to reduce poverty? Karnani claims it is best to focus available resources on creating jobs. For instance, China has created many factories based on low capital, labor intensive products – labor becomes more efficient and productive with time. How much a person earns depends on productivity, and productivity increases with scale economies. Consequently, the workers start earning more and poor people start moving out of poverty. When asked why microfinance and job creation could not be used simultaneously, Karnani responded, “Resources are limited, and you want to get the bang for your buck. Creating jobs will have bigger impact than microfinance.”

Role of Government, Civil Society and the Private Sector

Ultimately, Karnani argues that three types of players need to be involved in job creation: government, civil society, and the private sector. For Karnani, government needs to provide the infrastructure to do business and the basic necessities that will allow its citizens to work. “You cannot put up a factory in Sudan to make something,” Karnani said. “There is no electricity. There are no roads. There is a civil war going on. These people are suffering from famine and diseases... There, it is hard to see how the private sector is really going to do very much.”

The role of civil society, then, is to be a catalyst for change in government, to force the government to become more responsible. While some wealthy NGO’s, such as the Gates Foundation, are able to address specific problems such as malaria, most do not have the resources to be substantially effective; only governments can effectively address issues such as war or infrastructure. What these

NGO's can do, says Karnani, is force the governments to become more responsible. Civil society can also create jobs by abandoning its microfinance. For example, instead of giving \$200 to 500 women to buy a sewing machine, Karnani recommends that an organization give the total amount of money (\$100,000) to one person to create a large garment factory and that employs 500 people. This factory can achieve scale economies, find a competitive advantage, specialize and become much more efficient at creating value rather than one woman sewing clothes alone in her house."

Because they cannot effectively address the needs of the bottom billion, Karnani claims that for the private sector, BoP needs to apply to the next billion. Multinational companies should focus on creating jobs in this segment, even if the working conditions are initially less than ideal. Although often condemned in the developed world, Karnani argues that sweatshops are essential to poverty reduction because they provide jobs that otherwise would not exist – they are a positive step in the development process. Karnani does not advocate the use of child or prison labor, but he does believe the individuals from wealthy nations

**Earnings depend on productivity,
which increases with scale economies.**

**Consequently, workers earn more and people
start moving out of poverty.**

need to contextualize working conditions: "We are not talking about exploiting labor; we just think that these people working in these factories want to work there because that is better than the alternative," he said. "We have to contextualize because we can sit in the United States and say the conditions are terrible, but that's because we have the luxury of being in a much richer

place. I think what is happening is that there are a lot of people who are saying sweatshops are a bad idea, but they don't realize that when they say that they are hindering the job creation in these poor countries."

Furthermore, instead of exporting products, multinational firms should also consider making products for the local population. Most Chinese factories, for instance, are not producing products for export; most Chinese factories



are producing products for Chinese consumption. Large multinational companies, then, could set up factories that produce products for the local economies or be suppliers for their various products. The main idea is that the private sector – whether it is large companies, small, medium or some combination – emphasizes job creation for BOP rather than selling to BOP. If they do so, companies will help poor individuals earn income, even if the job entail a low wage and poor working conditions. Over time, Karnani argues, the working conditions will improve because there is more competition and the productivity rises. Then, the workers will say you know I should be paid more for what I do. Said Karnani, "All of this has got to start somewhere."

Bibliography

Karnani, Aneel. 2006. "Fortune at the Bottom of the Pyramid: A Mirage." Ross School of Business Working Paper 1035.

Prahalad, C.K. 2004. *The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits*. Upper Saddle River, NJ: Wharton School Publishing.

Launched by Woodward Partners in 2007, **Woodward Fellows** is a non profit research foundation based in the United States. Woodward Fellows probes strategic management issues in Asia Pacific to better understand the challenges firms face in the region, explore the application of research to these challenges, and contribute to the research field through partnership with leading institutions. In doing so, Fellows seeks to build bridges between scholarship and practice.

To subscribe to Woodward Fellows Management Briefings, please email subscribe@woodward-fellows.org or visit our website.