



University of Navarra

Center for Globalization and Strategy

Notes on Globalization and Strategy

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CREATING MARKETS IN UNEXPECTED PLACES



Christian Seelos
IPSS Director

The Unfinished Business of Economic Development Wanted: New Solutions

How can companies create and occupy new market space in the context of deep poverty? Leveraging existing capabilities and linking to local entrepreneurs helps companies achieve more inclusive economic development and significant financial returns.

Large-scale economic growth is a very recent “discovery” in human society. Only in the last seconds of our history have combinations of technological and organizational innovation, entrepreneurial individuals and emerging institutional structures succeeded in creating enormous wealth not only for elites but for mass populations. This has translated into real improvements in quality of life.

But two unintended consequences of this rapid and recent change pose serious challenges for the current economic system. First, most people have been bypassed by this economic development and are relatively worse off today. Second, use of finite natural resources and the accumulation of waste byproducts threaten the quality and capacity of our environmental life support systems and thus our ability to sustain economic growth.

New Questions Needed

Einstein said that we could not solve our problems with the same type of thinking that created them. Similarly, we urgently need new solutions to extend the benefits of economic development

to those left behind. But humankind and nature must form a healthy balance in doing so. Future generations should be free to make their own decisions, not hamstrung by the mess we left because we didn’t learn and adapt from the big global economic development experiment. And we can achieve all of this only if we don’t stifle entrepreneurial endeavor and the incentive systems that motivate involvement in economic activity.

The good news is that a number of case studies already point the way to new solutions. In Europe, IESE is at the forefront of “social entrepreneurship” research. Also, business education is starting to address these pressing needs. In 2004, IESE introduced a new course, “Entrepreneurial Strategies for Social Impact”, which last year won the school’s “Outstanding New Course” award.

A Triple Dilemma: Last-developed Countries

Research into competitive strategy has identified resources and capabilities as essential building blocks for competitive success. Most economic

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Sometimes it is easier to recognize opportunities for growth and new wealth creation than it is to work out how best to exploit them.

Information on such real-life applications attracts interest beyond academic circles. Our research last year won the Strategic Management Society's "Best Paper for Practitioner Implications" award.

resources and capabilities are built up through competition over how to best serve customer needs. Research has also furthered our understanding of how to leverage existing resources and capabilities and how to access those of local companies in order to enter less developed or emerging markets. Sometimes, however, it is easier to recognize opportunities for growth and new wealth creation than it is to work out how best to exploit them.

Our research at IESE has focused on countries where the most basic needs of millions of people are not being met and there are practically no markets to serve them. This provides a bizarre contrast to the mature markets in highly developed countries, where competition tends to optimize price-benefit ratios for consumers, enabling them to consume more of the things they want, not just what they need to survive. The latter is an important aspect of choice and perceived quality of life. But in the context of deep poverty, companies face a triple dilemma:

1. There may be no existing market to enter. Thus, an entry decision might hinge more on how to build markets and the necessary enabling institutional structures.
2. Doing it alone might not be feasible. A company's resources and capabilities have probably evolved in a very different environment and may be only partly relevant in a poor country.
3. The absence of markets translates into a scarcity of local partners and suppliers that could otherwise provide locally relevant resources and capabilities.

Creating New Market Space

Declining growth and rapid commoditization in existing markets puts great strain on man-

agement and tends to result in focus on value appropriation instead of new ways to create value. Cost-cutting measures, reorganizations and layoffs may increase efficiencies and productivity but stifle creativity and innovation.

Among the most popularized ideas on how to escape from the pressures of "hypercompetition" and lack of growth is the "Innovator's Solution" by Christensen and Raynor (1). They argue that managers should forget their obsession with existing customers and markets, usually seen as the sacred "core" of a company's business, and instead study the low-end disruptions that can lead to new products and services at radically better quality-price ratios. This could well be an ideal framework for poor countries, where innovation and low-end disruption may indeed be the only means to serve customers.

Similarly, Kim and Mauborgne (2) suggest creating and occupying new market space through value innovation. This involves a new combination of customer benefit elements and optimal trade-offs between the value of benefits and the costs required to deliver them. In underdeveloped countries, the absence of markets for many goods and even of whole industries might be the ultimate opportunity for creating market space. Therefore, the big question is: how can companies create and occupy new market space in the context of deep poverty? Partially answering the question of how to do this may be a prerequisite to deciding *whether* to do it.

Business Model Innovations

Next we provide some practical "how to" advice. This includes examples where, through working with local entrepreneurs in developing countries, companies have achieved more

Strategy and Sustainability at IESE

More momentum will be generated around these issues through our new center, the IESE Platform for Strategy and Sustainability (IPSS).

www.iese.edu/en/RCC/IPSS/Home/IPSSHome.asp

Also, a new course, "Strategy and Sustainability," will help equip IESE's MBA students to deal with complex managerial decisions impacting on sustainability issues such as poverty and inequality, pollution, water stress and climate change.



inclusive economic development and attracted significant financial returns. We also show how to use market mechanisms to deal with negative environmental impacts and how to make economic growth more sustainable through new types of highly-profitable business models.

References

- 1 "The Innovator's Solution: Creating and Sustaining Successful Growth", by Clayton M. Christensen & Michael E. Raynor, Harvard Business School Press; 2003
- 2 "Blue Ocean Strategy: How to Create Uncontested Market Space and Make Competition Irrelevant" by W. Chan Kim and Renée Mauborgne, Harvard Business School Press; 2005

We will generate more momentum through our new center, the IESE Platform for Strategy and Sustainability (IPSS) and a new course, "Strategy and Sustainability".

How to Successfully Enter Markets of Profound Poverty

In their pioneering work on social entrepreneurship, Professors Christian Seelos and Johanna Mair combine powerful ideas and practical advice. Here we provide a snapshot of their award-winning research.

According to the Bottom of the Pyramid (BOP) theory, multinationals can serve the world's poorest and also grow profitably. To do so, they need new business models, resources and capabilities, and are usually urged to partner with various local organizations. However companies have been told little about how to actually take this complex and costly step into the unknown.

In their award-winning paper "Profitable Business Models and Market Creation in the Context of Deep Poverty: A Strategic View," Seelos and Mair use two case studies to show how to assemble existing building blocks into new business models. The following are examples of companies leveraging their corporate capabilities to provide scale to proven organizations at the BOP and together serve the poor, increase their incomes and create profits.

Mobile Mobilization

The banking industry believed it was impossible to make money through the provision of micro-loans to the poor, but Grameen Bank, founded by Professor Muhamad Yunus in 1976, proved the industry wrong. In 2006, Yunus and his bank were awarded the Nobel Peace Prize for their contribution to social entrepreneurship.

In the 1990s, when the telecom industry believed it was impossible to make money serving poor customers in Bangladesh, the Norwegian telecom business Telenor (which faced saturation in its home market) banded together with Yunus to prove the industry wrong again. Yunus' support was critical for Telenor's reputation and reduced the possibility of corruption. The joint venture also gave Telenor important local knowledge.

They formed two separate organizations:

- GrameenPhone, a commercial company, was operated by experienced Telenor managers with the aim of maximizing financial returns.
- GrameenTelecom was set up to translate Grameen's successful microfinance system to the phone venture while maximizing jobs for the rural poor.

Grameen Phone began operating in 1997, by 2000 was profitable and by 2006 had passed 6 million subscribers and held 60 percent of market share. It is now one of Bangladesh's biggest private companies. Meanwhile, by 2006, GrameenTelecom had created more than 250,000 jobs for microentrepreneurs that it calls "Village Phone Ladies," poor rural women who generate income from a mobile phone, such as through providing a village phone service.



Christian Seelos and Johanna Mair
IPSS Director and IESE Professor



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Examples of companies leveraging their corporate capabilities to provide scale to proven organizations at the BOP and together serve the poor, increase their income and create profit.

Waste Not, Want Not

In Dhaka, the capital of Bangladesh, the city council was spending a quarter of its budget on waste removal but able to deal with less than half the rubbish. Odorous trash piled up in the streets and landfill sites, creating serious social threats including disease. Meanwhile, Bangladesh had a seemingly unrelated problem with overuse of chemical fertilizers. Two entrepreneurs, Maqsood Sinha and Iftekhar Enayetullah, saw a link. In 1994, they launched Waste Concern, based on turning waste into compost to replace chemical fertilizers. They soon saturated the home garden market and eventually persuaded the largest fertilizer company, Map Agro, to sign a "trial contract" that guaranteed sales of 200 tonnes of compost. Demand quickly pushed this figure up to 50,000 tonnes.

The new value chain created jobs for the poorest in the community and lowered their exposure to health threats. And since Waste Concern helped the government deal with a serious problem, in return, the government donated the land needed for the compost plants. The profits generated for Map Agro were so impressive that three other fertilizer companies went on to compete with Map Agro for a partnership with Waste Concern.

Recommendations

Based on their study, Seelos and Mair offer some advice for companies to increase their chances of successful entry in an under-developed market:

- Scan prospective countries or regions for organizations with business models able to serve the poor.
- Understand the strategic objectives, culture, and organizational structures of these organizations.
- Build relationships with a number of organizations as early as possible. Adequate BOP partners may be scarce. Identifying them early may reap first-mover advantages.
- Identify important bottlenecks in the model of local partners that prevent them from achieving strategic goals; build your business models around providing the missing element.
- Design your business model by thinking about replicating your existing competencies to support building markets in foreign countries, or redeploying competencies by existing country organizations to build new product markets.
- Ensure that the business model supports an increase in the real income of people.
- Monitor the dynamics of the environment and/or the development of your partner's overall model and strategic objectives.

Award-Winning Research

Thanks to its unique insights and balanced practical applications, the groundbreaking research of IESE Profs. Christian Seelos and Johanna Mair has won two major international prizes.

Last year, it attracted the Strategic Management Society's inaugural "Best Paper for Practitioner Implications" award.

This March, it won first prize in the prestigious second annual International Finance Corporation/Financial Times essay competition. (The International Finance Corporation is the private sector arm of the World Bank Group.)

To request a digital version of the full research paper please email the Center for Globalization and Strategy at globalcenter@iese.edu.



The Future will be Dynamic in the Developing World

In Bottom of the Pyramid markets, connectivity equals not just productivity but improved well-being. Here Global Challenge Network President William J. Kramer looks at which dynamic mobile phone applications are both needed and wanted by the billions of new customers.

Mobile phones may win the battle to become the new “desktops” for billions of people, starting in the emerging markets. What will make successful strategies for manufacturers, carriers, and their business ecosystems? Expect dynamic applications to feature.

Even casual readers will already know of the global explosion in mobile communications. At the annual Mobile World Congress, held in February in Barcelona, the focus was on the ubiquitous mobile. We’re not quite there yet. Traffic is still predominantly voice, but texting, music and videos are of increasing importance. And soon, financial services will be as common on handsets as SMS and just as easy. PBM – pay, buy, mobile (cute, no?) – is on its way. Innovation is being driven by these new uses but many handset manufacturers and carriers are just adding bells and whistles. The common business model seems to be constant platform obsolescence driving purchase of new equipment, which requires new operating systems, which creates opportunities for new software and functions, and so on...until the customers rebel.

Many of these functional upgrades – such as photos, music and videos – demand more and faster internal operations, more sophisticated operating systems, and greater local storage capacity – but add little traffic.

The real payoff for carriers will come from new, consumer-driven uses demanding constant back-and-forth traffic. Trillions of tiny, individual transactions together make for very large, and profitable, numbers. These new uses are dynamic applications – they are iterative and interactive, hence traffic-building.

And this is already unfolding but mainly in the emerging markets (EMs) and largely out of sight. EMs are the engine of handset growth. India and China add hundreds of millions of new users every year. Industry-watchers expect the EMs to drive every aspect of the industry. Dynamic applications will, I believe, be a major factor in this growth.

So what do EM customers want and need? Research by myself and my former colleagues at the World Resources Institute suggests that they place very high value on mobile communications. Even very poor people are willing to spend up to six percent of their income on telecommunications. In 2002, global ICT was conservatively estimated to already be a \$50 billion market. Why the enormous appetite for telecom services? It’s simple but largely unanswered by industry: connectivity equals productivity.

But which dynamic applications are both needed (and wanted) by the billions of new customers, and sufficiently iterative and transaction-heavy for the industry to sustain? The list is long: education and training, front and back office business operations management, agricultural services, and general commercial transactions. Of many possibilities we have room to briefly examine just two: financial and health services.

Financial Services

As mentioned, PBM is on its way. The technology exists, it just awaits broad deployment. A low-end estimate is that commerce-over-mobile will alone be a half-trillion dollar industry by 2011. Financial services over mobile are already a reality in some emerging markets:



William J. Kramer
President of Global Challenge Network

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Eventually nearly everyone will have a mobile, a status desktops will never achieve. In the developing world, mobiles are a necessity, not a luxury.



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The capacity for mobile applications to deliver massive improvements in life circumstances for the Base of the Pyramid demands attention.

Mobiles can do much of the work of development - increasing productivity, improving health and well-being, and providing access to knowledge and skills.

Vodafone, with its Kenyan affiliate, Safaricom, for example, has introduced a highly successful platform in Kenya, M-PESA. The service, which started as a public-private partnership with funding from DFID and Vodafone, was originally designed as a tool for managing micro-credit transactions.

In the Philippines, mobile carriers Smart Communications and Globe Telecom have created a virtual currency of credit for SMS text message units.

Extraordinary growth here is largely not directed by the carriers; but a response to customer demand. Very low income consumers are spending scarce disposable income on highly sophisticated applications.

Unmet Potential in Health Services

In health services, telecoms are in use, but with huge unrealized potential. Voxiva is employing both wired and mobile phones for disease detection, reporting and record management systems. South Africa uses mobiles for management of HIV/AIDS, TB and other disease treatment, and of patient medication, via voice and SMS text messages.

Research is needed on whether mobiles can deliver better health outcomes but it's easy to imagine the well-being benefits and commercial implications of people having their full medical records on their mobile, immediately accessible to doctors over secure networks.

Implications for Strategy

Eventually nearly everyone will have a mobile, a status desktops will never achieve. In the developing world, mobiles are a necessity, not a luxury. This capacity for mobile applications to deliver massive improvements in life circumstances for the Base of the Pyramid (as opposed to the incremental life benefits that any new application brings to rich customers) demands attention. As phones become more technology-rich, new applications can define new business models and add significant revenues and profits. They can also do much of the work of development - increasing productivity,

improving health and well-being, and providing access to knowledge and skills. In other words, connectivity equals not just productivity but also improved well-being in these markets.

Carriers, manufacturers, and their respective ecosystems, have yet to focus on pushing the envelope on dynamic applications. I see two logical and immediate openings.

- Chipset manufacturers, particularly the flash memory companies, would do well to explore these applications. Flash memory is already the technology of choice for mobiles, cameras, PDAs, and laptops. Memory is a commodity business - success demands ability to provide specialized chips in bulk. The markets mentioned here are thus ideal for this part of the industry but it must rethink who its customers are, what partners it should seek, and where future growth can be found.
- GSM (Global System for Mobile communication) is under-utilized. The industry should cultivate more dynamic application use inside and outside firms - the payoffs would be much greater than from somewhat cheaper new handsets. This is the strategic opportunity which could redefine the role of ICTs for many generations.



Buried Treasure: One Billion New Consumers with \$1 Trillion to Spend

Imagine discovering a huge new market of a billion people with voracious, unmet demand. Serving them profitably won't be easy but companies that succeed will reap a big reward.

Companies from around the world are charging boldly into Africa, Brazil, China, India, and other parts of Asia. However, they have been reluctant to push beyond the familiar affluent customers they have long served in developed markets.

They are largely ignoring a vast, untapped and rapidly growing group of consumers. More than one billion people in rapidly developing economies (RDEs) have emerged as a distinct segment poised for continued growth and voracious consumption. For companies that can figure out ways to serve them profitably, the next billion represent an enormous opportunity to generate new revenue and create innovative products, services and ways of doing business that will provide lasting advantage in all markets.

Categorized by income, the next billion sit just above the poorest of the poor and just below the "top of the pyramid." Collectively, they spend just over \$1 trillion a year. If these consumers were a nation, it would be the tenth-largest economy in terms of GDP, coming after Spain but ahead of Brazil, Russia, India, South Korea and Mexico. In its development, the next billion nation is today where India stood in the 1990s and China in the 1980s — on the cusp of high growth and voracious consumption.

Yet the next billion pose a conundrum for businesses. They are brimming with real demand for products and services. These consumers are willing to tolerate the usurious rates, shoddy products, substandard service, and limited choice that pervade the informal channels on which they're forced to rely. But today the next billion are unprofitable to serve on the basis of conventional business models. Companies can profitably reach these consumers, but only by reorienting their products, marketing, distribution, and organizations.

In Brazil, two-thirds of the country's 53 million households fall into this segment. China and India have far more households — 214 million and 91 million respectively — that qualify as members of the next billion. Their monthly household incomes vary widely based on country and location, ranging from \$100-\$700 in Brazil, \$63-\$375 in China, and \$74-\$333 in India.

A diverse segment, these consumers nonetheless share several important characteristics:

- they spend up to a third of their earnings on non-essential items such as perfume, chocolate and televisions — evidence that they are making product and brand choices
- their incomes are growing faster than their countries' underlying economies
- they harbour aspirations similar to the segment above them
- they are young, with 40 years of consumption ahead of them

These are discerning consumers. They will not settle for cheap, stripped-down versions of mainstream offerings. They value and will pay for convenience, flexibility, and timeliness. Still, the needs of the next billion are distinct from those of existing customers. They usually have limited and often unstable financial resources and so are wary of large up-front outlays and commitments to recurring expenses. In addition, they also have physical constraints: many live in tiny dwellings, without a permanent electricity supply or running water.

A small number of companies — both large multinationals and domestic leaders from RDEs — is figuring out ways to profitably serve the next billion. Their "secrets of success" include

- Designing products with functions and prices that compensate for poor living conditions, unreliable utilities, limited budgets and other constraints.



David R. Dean
Senior Partner & Managing Director, The Boston Consulting Group, Munich

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- Partnering with existing networks to ensure broad coverage, low cost and reasonable control. In Mumbai, telecom operators market SIM cards through the dabbawallas, a network of 5,000 men who deliver homemade lunches from suburban kitchens to downtown offices.
- Conducting educational marketing programs that explain the importance of a product's benefits.
- Collaborating with companies from other industries – even competitors – to enhance consumer programs and improve economics.
- Leveraging business models across multiple markets. The M-Pesa service of Vodafone/Safaricom in Kenya allows customers to perform money transfers by mobile phone and will be rolled out to Afghanistan, India and other African markets.

- Organising for the next billion. The innovators tend to house their next billion activities in a distinct organisational unit in order to experiment without being saddled by the existing practices of the parent organisation.
- Working with regulators and policymakers so that they recognise the commercial viability of these consumers and will allow market forces to work.

In the next few years, the next billion will accelerate their climb up the economic ladder. Companies that win their loyalty early will capture the lion's share of the opportunity. Those that devise the right offerings and create the strategies that radically change the economics of serving this segment will generate long-term competitive advantage from the next billion.

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THE CENTER REPORTS

IESE's Alumni Association has awarded its 2007 Research Excellence Awards to Professors África Ariño, Tony Dávila, Christian Seelos and Johanna Mair.

The prize for "Best Academic Article Published in a Top International Journal" went to Ariño for her article in the Strategic Management Journal in 2007. Written in collaboration with Ohio State University Prof. Jeffrey J. Reuer, it was titled: "Strategic Alliance Contracts: Dimensions and Determinants of Contractual Complexity."

The "Development of a New Course or Program Teaching Material" prize was won by Seelos and Mair for the course they

developed, "Entrepreneurial Strategies for Social Impact."

"Best Book Published in Terms of International and Business Impact" was awarded to Dávila for the book series "The Creative Enterprise. Managing Innovative Organizations and People," which was co-edited by Profs. Marc J. Epstein and Robert Shelton.

Activities The Center for Globalization Strategy was one of the partners in the fifth annual "Doing Good and Doing Well" conference, held on IESE's Barcelona campus from February 29 to March 1. This year the conference, which is organized

by IESE's full-time MBA students, featured more than 100 speakers and attracted more than 350 participants, from more than 50 countries. Responsible banking, social entrepreneurship and climate change were some of the key topics discussed.

Among the speakers were GE regional vice president Daniel García Guelbenzu; Charity Bank founder and CEO Malcolm Hayday; Volans Ventures founding partner and Schwab Foundation former director Pamela Hartigan; Boston Consulting Group senior partner and managing director David R. Dean; KenCall co-founder and CEO Nik Nesbit; and Base of the Pyramid Learning Lab in India director Reuben Abraham.

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