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SOCIAL EMBEDDEDNESS IN LOW-INCOME MARKETS: INFLUENTIAL FACTORS AND POSITIVE OUTCOMES

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Abstract

Strategy in low-income markets is a new but emerging field of international strategy research. Because low-income markets remain largely unexplored and unknown to most companies, it has been argued that developing embedded ties and alliances with traditional and non-traditional partners is critical in order to better understand customer needs and market characteristics. Following this logic, the purpose of this paper is to explore the antecedents and consequences of developing a capability in social embeddedness in low-income markets. Using a multiple-case inductive analysis of business ventures and their embedded ties and partnerships in this context, we propose an emergent theoretical framework to explain the factors that influence the development of such a capability and its positive outcomes. Our findings suggest that a firm has a greater incentive to build embedded ties and partnerships under three conditions: when the market-oriented ecosystem is underdeveloped; when the firm's psychic distance with respect to low-income markets is high; and when the firm offers a large number of product complementarities. A capability in social embeddedness can be beneficial for obtaining fine-grained information, increasing operational efficiency, gaining trust and legitimacy, and having prior access to new markets. At the same time, the social network in which a firm is embedded gives access to network resources that can provide competitive advantage.

Keywords: Low-income markets, social embeddedness, networks.

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Introduction

Until recently, the 4.6 billion people who are excluded from the market economy and live in poverty were considered anything but a market. That is hardly surprising, as it is hard to imagine a person who subsists on less than 4 dollars a day[1] being able to afford goods and services developed and supplied to people earning many times her income. Consequently, business interaction with the poor has been scarcely touched upon in the strategic management literature (Steidlmeier, 1993). However, recent work by several authors (e.g., Hart & Christensen, 2002; Hart & Sharma, 2004; London & Hart, 2004; Prahalad & Hammond, 2002; Prahalad & Lieberthal, 1998; Prahalad & Hart, 2002; Prahalad & Ramaswamy, 2004) has drawn the attention of academia and the business world to this subject. In brief, these authors suggest that by stimulating commerce and development in low-income segments, multinationals could radically improve the lives of billions of people and help create a more stable and inclusive world.

In order to succeed in this challenging goal, rather than replicating previous models and strategies, companies need to innovate in strategies, business models and products, as every single article on this topic has repeatedly emphasized. Some authors have expanded this vision by arguing that companies must develop embedded ties and alliances with traditional (local firms) and non-traditional partners (local communities and entrepreneurs, NGOs, aid agencies, etc.) in order to better understand local customer needs and market characteristics (London & Hart, 2004). Embeddedness can be understood as a unique logic of exchange aimed at cultivating long-term cooperative relationships that have both individual and collective benefits for learning, risk-sharing, investment, and time to market (Uzzi, 1996). Furthermore, a firm embedded in a social network will have access to key resources in its environment, such as capital, information, access, or goods, that have the potential to maintain and enhance the firm's competitive advantage (Gulati, Nohria & Zaheer, 2000). All these benefits are relevant because they tend to reduce the high uncertainty inherent in entry to low-income markets by enhancing trust between actors (Granovetter, 1985) and favoring knowledge acquisition (Uzzi, 1996). This knowledge can lead to more sensitive innovations which meet user needs and incorporate desired functionality (Hart & Christensen, 2002). At the same time, developing such ties and alliances favors capability development beyond firm boundaries, which can generate both economic and social benefits. Taken together, these arguments suggest that firms that have a capability in social embeddedness are most likely to be successful when entering low-income markets (London & Hart, 2004).

Despite the evidence that embedded ties and social networks can be beneficial for firms, several questions remain unexplored. For instance, what factors influence the need to develop a capability in social embeddedness? What value do embedded ties generate in low-

[1] According to the World Bank development indicators, in 2003 a total of 2,505.9 people live in low-income economies with a GNI per capita of US$430, and 2,163.5 people live in lower-middle-income economies with a GNI per capita of US$1,160 (Atlas method). In this paper, when we talk about low-income segments or markets we refer to the aggregate sum of these two groups living with less than 4 dollars a day.

income segments where markets remain underdeveloped? In this paper, *we explore the antecedents and consequences of developing a capability in social embeddedness in low-income markets*. This issue is especially relevant for two reasons. First, it represents an advance toward an understanding of the conditions under which a firm can profitably serve low-income markets. Second, it offers new insights for evaluating the impact of business in the local environment.

Given the lack of prior theory on social embeddedness in low-income markets, we conducted a multiple-case inductive study. To get a complete understanding of the factors that influence the need to develop a capability in social embeddedness and the benefits of doing so, we chose five multinational companies that compete in different geographical markets and sectors, and that have obtained different results in their ventures in low-income markets. These cases include three successful ventures (CEMEX, Tetra Pak and Unilever), a failed one (Nike), and one with mixed results (a Spanish multinational, which we shall call Star[2]). These cases were chosen because of their learning potential and rich diversity, which are essential attributes when conducting exploratory research (Eisenhardt, 1989).

From these data there emerges a theoretical framework explaining the antecedents and consequences of developing a capability in social embeddedness in low-income markets. We have identified three factors that influence the need to develop a capability in social embeddedness: the degree of development of a market-oriented ecosystem; the psychic distance between the firm and the host country[3]; and the product complementarities offered by the firm. While the first factor is negatively related to the need to develop a capability in social embeddedness, the second and third factors are positively related. We have also identified the benefits and resources which, in turn, can be obtained by developing a capability in social embeddedness. They are: fine-grained information about the local market and institutional system; enhanced operational efficiency; trust and legitimacy to operate in the market; and access to new markets. As having a capability in social embeddedness implies forming a social network, the firm will very likely gain network resources that have the potential to confer competitive advantage. Some common network resources observed in other studies and confirmed in our analysis are: network structure, understood as the structural patterns of a firm's relationships; network membership; and tie modality (Gulati, 1999; Gulati et al., 2000). Interestingly, we have identified a fourth network resource that is especially important in low-income markets: transparent transaction governance capacity. This is a capacity that a firm must build jointly with the constituents of the ecosystem. Ultimately, it allows for effective transactions among the different constituents. This is especially relevant in low-income markets where institutional systems are normally characterized by asymmetries of information, lack of transparency and trust, few regulations to enforce contract compliance, weak distribution channels and systems to support business growth, and absence of demand for certain goods (Hoskisson, Eden, Lau & Wright, 2000; Khanna & Palepu, 1997; Meyer, 2001).

Methods

Research strategy

Because business in low-income markets is a complex social phenomenon with multiple players involved and no clear boundaries to its context, a qualitative approach seems appropriate to answer the research questions (Yin, 1994). Qualitative research, rather than

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[2] For reasons of confidentiality, we use the fictitious name "Star" when referring to the Spanish multinational.
[3] As we will see later, the concept of psychic distance, as used in this paper, includes not only geographical and cultural concerns –as has been traditional– but also experience in low-income markets.

traditional quantitative empirical tools, is particularly useful for exploring implicit assumptions and examining new relationships, abstract concepts, and operational definitions (Bettis, 1991; Weick, 1996). Also, a lack of prior theorizing about a topic makes the inductive case study approach an appropriate choice for developing theory (Eisenhardt, 1989). According to Yin (1994), case studies are especially suitable when the aim is to understand complex contemporary social phenomena in their real-life context. This author states, in addition, that case study research can have, among others, exploratory and explanatory applications. All these motivations fit with the intention of our study: first, to explore *what* factors condition the need to develop a capability in social embeddedness; and second, to understand *how* such a capability may benefit the firm and its context.

Our research design was based on multiple cases, thereby allowing for replication logic in which cases are treated as a series of experiments, each serving to confirm or disconfirm inferences drawn from the others (Yin, 1994). This replication process allows the development of a rich, theoretical framework in which it is possible to develop constructs that facilitate future hypotheses testing that are free of researcher bias (Eisenhardt, 1989). For working on the described research design and for theory building by qualitative case study research, other common qualitative research methods were used, such as qualitative data analysis (Miles & Huberman, 1994) and grounded theory building (Glaser & Strauss, 1967). This latter method is based mainly on an ongoing comparison of the data and the theory and is especially useful in the early stages of research on a topic (Brown & Eisenhardt, 1997).

Data collection and sample

The research was conducted over a period of two years and involved triangulation among a variety of different sources (Yin, 1994), including case studies, analyses of corporate web sites and public reports, open-ended answers to specific questions sent to selected companies, and news and articles from specialized media. We also conducted semi-structured interviews with managers directly involved in projects in low-income markets. In order to get a broad overview of business ventures in low-income markets and understand the firms' background and overall strategy, we designed a structured template in collaboration with Kenan-Flager business school, which covered information about: 1) context of the parent company and its venture in the low-income segment; 2) origins of the low-income segment venture; 3) market overview; 4) partners and alliances; 5) competitors; 6) low-income segment product/service overview; 7) business model; 8) current and historical challenges; 9) nature of firm's competitive advantage in the low-income segment; 10) triple bottom line impact assessment for the low-income segment venture; and 11) key lessons and opportunities.

Our sample is composed of five multinational companies from different geographical markets and sectors. These cases include three successful experiences (CEMEX, Tetra Pak and Unilever), one failed venture (Nike), and one with mixed results (Star). CEMEX sells cement, concrete and aggregates. In Mexico, it launched the "Patrimonio Hoy" project to serve the do-it-yourself homebuilding market. CEMEX has transformed itself from selling a raw material to providing an integral service, including technical assistance and financing. Tetra Pak develops processing systems and supplies complete processing and packaging lines to the dairy and beverage industries. Under the Food for Development Program, a private-public partnership led by Tetra Pak, about 20 million children in developing countries receive food in Tetra Pack packages annually. This program also acts as a catalyst for agricultural and economic growth, and better health and education. Unilever's subsidiary in India, Hindustan Lever, developed new products and distribution systems to serve low-income markets. Initially, they focused on marketing health and hygiene-related products. Nike aimed to introduce a new line of sports shoes for the low-income segment in China, but discouraging results halted the operation. Finally, Star is competing in the processed food industry in 70 developing countries. While in some markets it has achieved a leading position (e.g., Senegal, Gambia and Russia), in other markets it is facing serious problems (e.g., China).

Data Analysis

Our data analysis started with individual case studies (Eisenhardt, 1989). We incorporated all the information collected from different sources in a case write-up of the business model structure. We focused on the structure of the business model because that involved analyzing the parties to the exchange, the ways they are linked, and their governance arrangements (Amit & Zott, 2001). We then compared the business model designed for serving low-income segments with the firm’s business model in premium markets. This comparative analysis allowed us to identify the main differences and similarities in the structure and components of the firm’s business model and build explanations for the underlying reasons for those differences and similarities (Yin, 1994). At the same, time we observed the development of ties and partnerships in different business activities (e.g., marketing, distribution, manufacturing, supply chain, etc.) in order to identify possible patterns and commonalities. Once the individual cases were finished, we began cross-case analysis to deepen understanding and explanation (Glaser & Strauss, 1967) and enhance analytical generalization (Miles & Huberman, 1994). Using tables, we compared cases for similarities and differences and identified the potential variables of interest. We contrasted our findings by looking for the identified factors in each individual case (Glaser & Strauss, 1967). From this iterative process the following results and theoretical framework emerge.

Results

Multi-case inductive analysis of the data led to a series of findings that explain the antecedents and consequences of embedded ties in low-income markets. The findings suggest that a firm has a greater incentive to build embedded ties and partnerships under three conditions: underdeveloped market-oriented ecosystem; high psychic distance of a firm with regard to low-income markets; and high number of product complementarities offered by the firm. In turn, a capability in social embeddedness can be beneficial for obtaining fine-grained information, increasing operational efficiency, gaining trust and legitimacy, and having prior access to new markets. At the same time, the social network in which a firm is embedded provides some network resources that can serve as a source of competitive advantage (Gulati et al., 2000). Before going into the details of these findings, it is important to describe how we measured the level of a firm’s embeddedness in its social context.

We differentiated among three levels of social embeddedness. In this analysis we distinguished among embedded ties –close and deep relationships with an external party without any formal agreement or contract– and partnerships –formal agreements between two or more parties to achieve a common goal. A high level of social embeddedness implies that a firm has embedded ties and partnerships with several groups and parties in a large number of business activities. A medium level implies that a firm has embedded ties and partnerships with a small number of groups and parties in a small number of business activities. And lastly, a firm with a low level of social embeddedness restricts its operations to arms-length relationships.

Tables 1a and **1b** detail the analysis of social embeddedness for all the companies in our sample. According to these results, CEMEX, Tetra Pak and Hindustan Lever have achieved a high level of social embeddedness, Nike has a low level, and Star has a level varying from low to medium, depending on the country observed.

Table 1. Social embeddedness analysis

Firm	Embedded ties			Partnerships		
	Business activity	***Parties involved***	***Motivation***	***Business activity***	***Parties involved***	***Motivation***
Cemex (CM)	• Business model design process • Distribution • Marketing	• Multidisciplinary research team with local community members • PH cell managers with distributors • PH cell managers with customers and community leaders. Ties between customers	• Learning and engagement • Engage distributors and fill a structural hole between customers and distributors • Promote a sense of co-responsibility; gain trust; increase commitment and rate of on-time payment	• Funding • Human resources • Supply chain • Marketing	• CM and World Bank • CM and Ashoka • CM with firms offering complementary products • CM with SEDESOL	• Expand program rapidly to other regions • Find local entrepreneurs for new cells. Perform this process more efficiently. • Add value to customers by offering an integral service • Government endorsement adds credibility and attracts more people to the program
Tetra Pak (TP)	• Business model design process • Packaging • Recycling	• TP program directors with goverments and NGOs • TP with customers, local NGOs, users, children, parents • TP with local community and schools	• Learning and identification of needs • Understand needs for packaging design • Design best solutions for recycling waste	• Funding • Distribution • Marketing	• FfDO with aid agencies, UN World Food Programme, etc. • Network of partners • Network of partners	• Extend programs to new regions • Market development • Financing for technical equipment; education & training for dairy farmers and plants; social awareness of milk benefits
Hindustan Lever (HL)	• Distribution • Marketing • Human resource development	• HL with Shakti Ammas • HL with Shakti Ammas • HL marketing managers and local communities	• Extend distribution in rural villages door-to-door in a cost effective way. Obtain trust/legitimacy • Perform promotional activities in a “close-up way”. Obtain better knowledge of consumers’ needs • By spending two months living in rural villages, managers can better understand local habits and needs and develop new products accordingly.	• Human resources • Distribution • Marketing	• HL with MART (consulting firm) and regional governments, as well as local NGOs • HL with local NGOs • HL with regional governments, NGOs, private firms	• Get access to SHGs and identify best locations and dealers. Train dealers in a cost effective way. Obtain trust and legitimacy. • Extend Shakti project amongst SHG in different states. • Overcome consumer habits and attitudes. Enhance awareness of HL’s products.
Star – Kenya (ST-KN)	• Distribution	• ST-KN with retail outlet owners	• “Human selling” is required to get deals	• Business set-up (market entry) • Distribution	• Joint venture • Joint venture	• Required by regulations • Better access to market
Star – China & Russia (ST-CH+RS)						
Nike (NK)						

In light of the results shown in these tables, we will first analyze how social networks influence different business activities. After that, we will detail the three factors that influence the need to develop a capability in social embeddedness. Finally, we will present the consequences of developing such a capability.

Social networks and business activities

The cross-case analysis of social embeddedness shown in **Tables 1a** and **1b** allowed us to identify some emerging patterns regarding the relevance of developing embedded ties and partnerships in different business activities. Our results show that those business activities in which embedded ties and partnerships seem to be most relevant are distribution and marketing. We also observed that partnering with local organizations for human resources recruitment can be especially useful when the business model relies on local entrepreneurs. Lastly, some firms have developed innovative business models by establishing embedded ties with local partners in the design process.

Distribution process

When trying to serve low-income markets, firms face a big challenge: how to make their goods *available* to customers (Prahalad, 2005). The target population is substantially bigger and normally is scattered in rural areas[4]. Furthermore, in contrast to the highly concentrated retail and distribution industry in developed markets, the retail trade in emerging markets is extremely fragmented (D'Andrea, Stengel & Goebel-Krstelj, 2004; Dawar & Chattopadhyay, 2002). At the same time, retailers have great influence on consumer buying behaviour (Letelier, Flores & Spinosa, 2003). According to Hindustan Lever, retailers influence 35% of purchase occasions. Star's general manager in Kenya also emphasizes how important it is to establish close ties with retail owners in order to develop a long-term commercial relationship:

> "Besides the commercial skills, a salesperson needs to maintain a very personal relationship with the 'mum', the outlet's owner, a relationship of friendship and joy".

Finally, one of the big barriers that firms face in low-income segments is the extremely high up-front market development costs. Multinational firms may find it really costly and challenging to develop a distribution channel on their own. That may explain why in our study we found partnerships and embedded ties to be so prominent in the distribution process.

The example of Hindustan Lever shows how it is possible to penetrate rural markets in a cost-effective way. The pivot of the distribution system is the rural distributor, who has 15-20 rural sub-stockists attached to him. Each of these sub-stockists is located in a rural market. The sub-stockist then performs the role of driving distribution in neighboring villages, using unconventional means of transport such as tractor, bullock or cart. Distribution is further extended with Project Shakti, Hindustan Lever's partnership with Self Help Groups (SHG) of rural women. The SHGs operate like direct-to-home distributors and have chosen to adopt distribution of Hindustan Lever's products as a business venture, armed with training from Hindustan Lever and support from government agencies and NGOs. A

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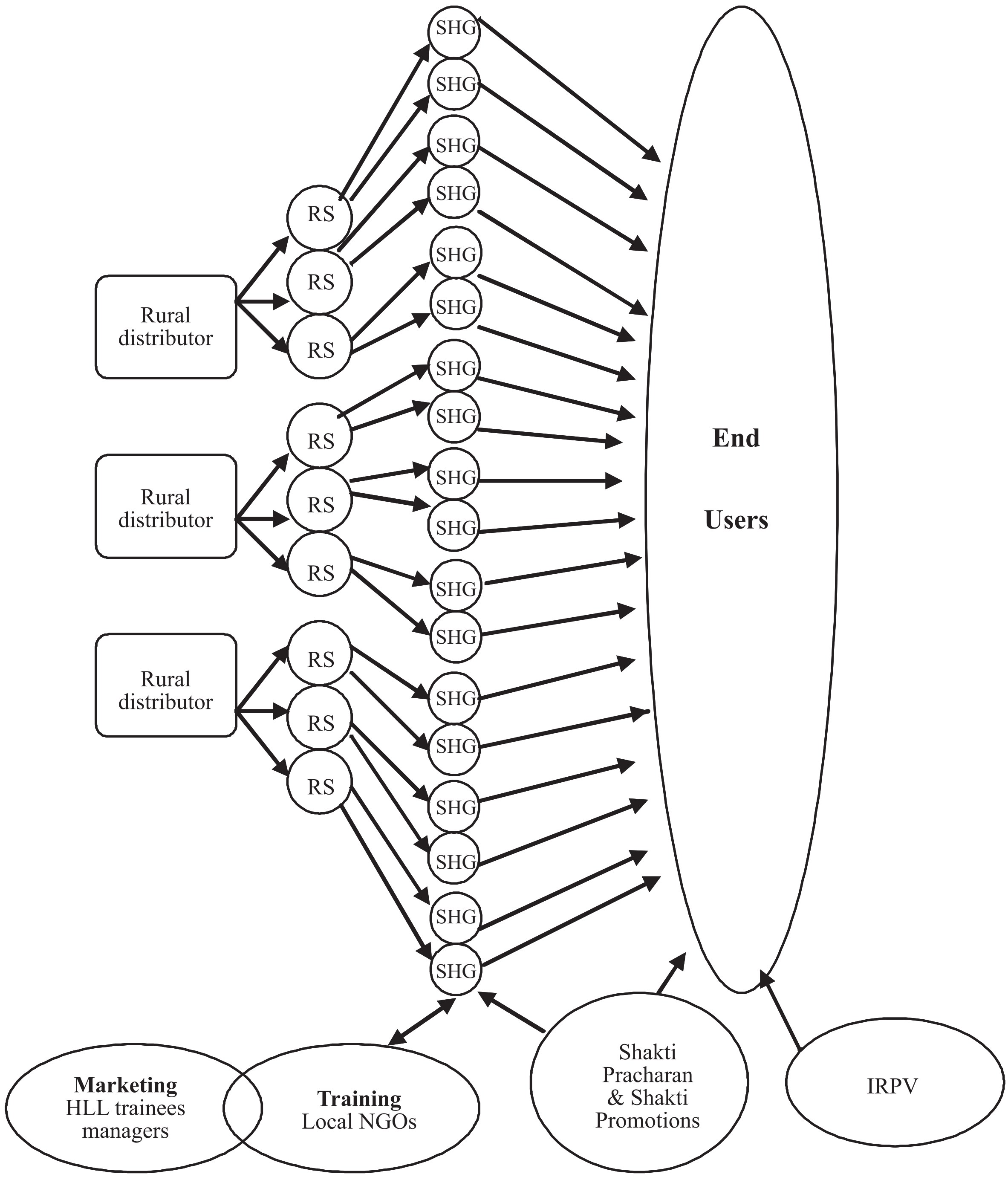
[4] In high-income economies, 77.5% of the population lives in urban areas. In low-income economies, the population living in urban areas is less than 40% (World Development Indicators, 2003).

typical Shakti entrepreneur takes micro-credit from banks and uses it to buy Hindustan Lever's products, which she will then sell directly to consumers. A Shakti entrepreneur conducts business of around Rs.15,000 per month, which gives her an income in excess of Rs.1,000 per month on a sustainable basis (**Figure 1** depicts the distribution system of Hindustan Lever). As a result, Hindustan Lever has penetrated rural markets through a network formation process with local women entrepreneurs and the support of NGOs and regional governments. At the same time, using existing social capital as a resource to build its distribution system has allowed Hindustan Lever to gain the legitimacy needed for entering this market.

Figure 1. Distribution system of Hindustan Lever



In contrast to Hindustan Lever, Nike relied on its traditional distribution system in China to market its World Shoe line for consumers in the so-called “tier three” segment (population with income of US$ 2,000 in purchasing power parity). This meant that models for tier three, which ranged in price from US$15 to US$22, were displayed together with premium models, priced from US$79 upward, in large retail stores in major metropolitan areas. In the end, the use of this distribution channel made it difficult to reach the target market. Besides, as Nike did not carry out any marketing actions or promotion campaigns, retailers were left without information on the unique features or intended markets of the World Shoe line.

Marketing activities

Making products attractive for low-income segment markets may not be as easy as expected for multinational firms. Lured by the prospect of billions of new consumers, some multinational companies may be tempted to transfer marketing programs which have succeeded in developed markets (Dawar & Chattopadhyay, 2002). Others may follow a low-cost strategy by subtracting product features and offering a downgraded version (Letelier et al., 2003). However, the use of marketing programs that are poorly adapted to low-income markets leads to low market penetration, disappointing market shares and low profitability (Dawar & Chattopadhyay, 2002). All in all, firms should understand customers’ needs and values, overcome some prevalent habits and attitudes, and build trust by engaging customers and reputed organizations. This requires using new marketing techniques and rethinking marketing programs from the ground up (Letelier et al., 2003; Prahalad & Hart, 2002).

Indeed, our results show that by partnering with local institutions and engaging customers as well as renowned people and groups, multinational companies can have a better knowledge of the market, gain legitimacy and trust, and educate consumers about the product benefits in a more sensitive manner. The example of Tetra Pak illustrates this point very clearly. In developing countries, milk is sold mainly loose. Tetra Pak thought that its aseptic technology could provide some advantages, such as enhancing the milk’s safety and nutritional value, and improving the efficiency of the distribution system by reducing the frequency of visits and permitting a longer shelf life in retail outlets. In order to develop the packaged food market, in more than 25 developing countries Tetra Pak has implemented its *Food for Development Program*, a school milk program which relies on a close partnership between the public and private sectors. Tetra Pak seeks the most appropriate partners in each country to develop the program, which combines farmer training and education with equipment financing on commercial terms and consumer education activities. Local institutions and organizations normally have different roles, such as disseminating the program through schools, monitoring program implementation at school level, educating children in all aspects of dairy farming, nutrition and the environment, and organizing and executing relevant educational and awareness-raising activities. In the end, this holistic approach in which different partners are involved permits the school milk programme to act as a catalyst that creates demand for locally produced milk and dairy products.

Human resources

Because two of the key issues when addressing products and services in low-income segments are *availability* and *awareness* of products and services (Prahalad, 2005), it was predictable and natural that our study should have revealed a high number of embedded ties and partnerships in the distribution and marketing processes. Less expected was finding alliances for human resources recruitment. This was especially important for firms that have developed a business model in which local entrepreneurs play a pivotal role.

Marketing and Research Team (MART) is HLL's implementation partner on Shakti, helping Hindustan Lever to identify prospective Shakti Entrepreneurs, as well as providing much needed entrepreneur and business training for the women in the initial stages. In this process Hindustan Lever also works closely with the rural development departments of the state governments, as well as a large number of NGOs across the regions it currently operates in. Similarly, CEMEX decided to partner with Ashoka –a global organization that searches the world for social entrepreneurs– to identify potential local entrepreneurs who would be able to run the Patrimonio Hoy cells efficiently. The fact that most of these entrepreneurs are well connected, well reputed people in the community makes the setting up of new branches (cells) quicker, allowing them to reach break-even sooner.

Business model design process

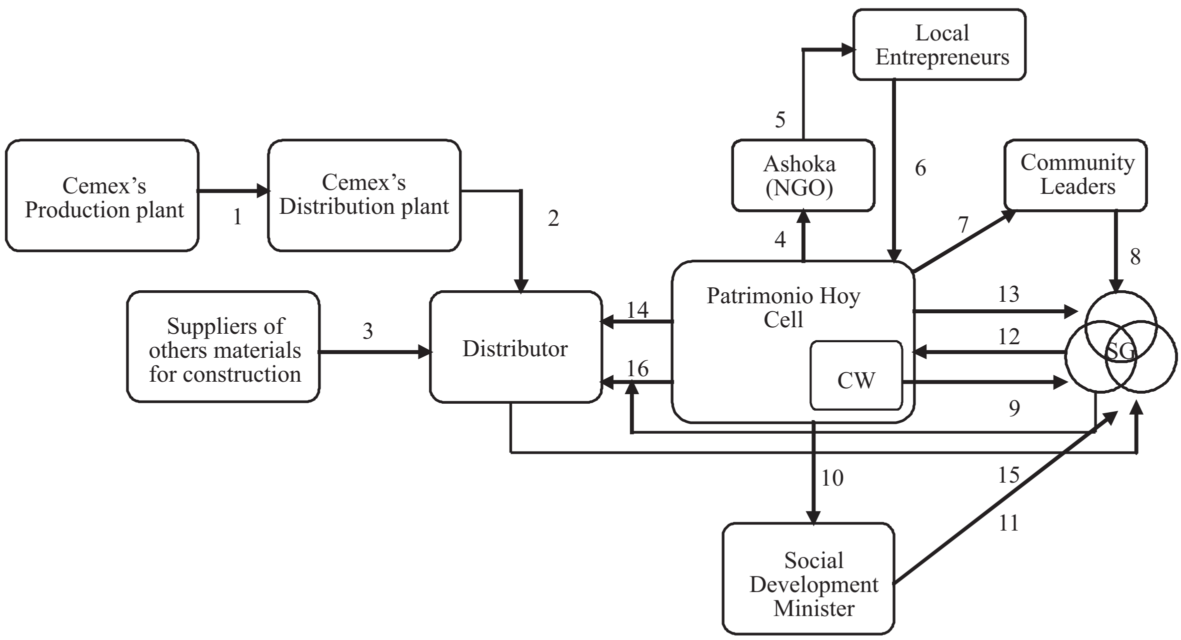
According to academics who have studied strategies in low-income markets, a radically innovative business model and strategy are required in order to succeed in such ventures (Prahalad & Hammond, 2002; Prahalad & Hart, 2002). Furthermore, it is suggested that in order to acquire the necessary knowledge to generate competitive imagination and manage disruptive change, firms should identify and integrate the views of fringe –non traditional– stakeholders (Hart & Sharma, 2004). Ultimately, that engagement should lead to the creation of innovative business models and strategies to tap into these new markets.

Our results partly confirm these ideas. On the one hand, it appears to be true that the firms that have created a more innovative business model –CEMEX and Tetra Pak– are the ones that have developed embedded ties with local community members, NGOs and local governments in the business model design process, favoring a bottom-up development process (Hart & Christensen, 2002; Prahalad & Hart, 2002). On the other hand, from our results we cannot conclude that a radically new business model and strategy are always required to serve low-income markets. For instance, Star is basically replicating its business model, with minor adaptations to local conditions, and yet its results are quite satisfactory in most of the developing countries in which it operates. Therefore, it would seem that certain factors may affect the need to develop a capability in social embeddedness. In the next section, we will extend our analysis of those factors.

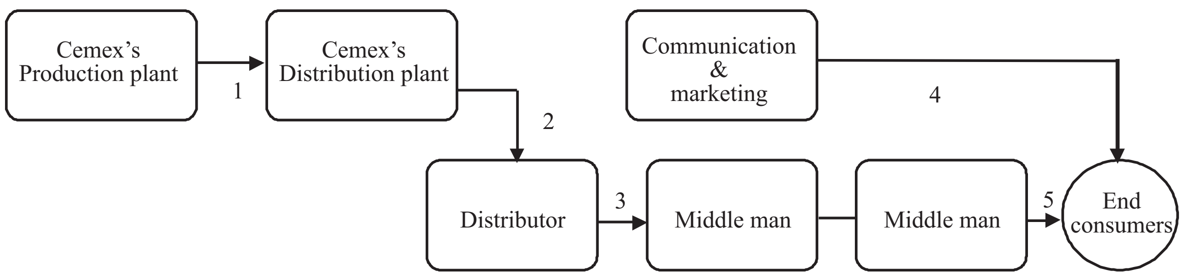
CEMEX provides a good example of an innovative business model. Recognizing that the lower economic class was a market so different from any in which CEMEX had competed before and that traditional market research techniques were not valid for this context, it launched an exploratory initiative to study the needs of the people at the lower economic level. CEMEX set up a team of seven employees with various types and levels of experience to explore and understand consumer's needs in the low-income market. This team lived for a year and a half in a poor city (Mesa Colorada in Guadalajara), where they developed close relationships with a variety of community members, villagers and local groups. During that time the team discovered three key challenges –lack of financial resources, lack of construction knowledge and lack of adequate services– that poor Mexicans faced when trying to build their own homes. In response to those unmet market needs, Cemex created a service business, called Patrimonio Hoy, which assisted the do-it-yourself homebuilder in the entire home building process, from securing financial resources to homebuilding training to materials supply. **Figure 2** shows the business model structure of the Patrimonio Hoy project and compares it with CEMEX's business model in the premium market for bagged cement. Numbers and arrows represent the order and flow among all the parties involved in a simplified manner. As we can see in this picture, the Patrimonio Hoy model is an innovative and entirely different value proposition from the business model adopted in premium markets.

Figure 2. CEMEX business models

Patrimonio Hoy



Business model in premium markets (bagged cement)



Influential factors for developing a capability in social embeddedness

Understanding the underlying reasons that might explain the need to develop a capability in social embeddedness was one of the main aims of this study. We identified three possible factors: the degree of development of a market-oriented ecosystem; the psychic distance between the firm and its target market; and the number of product complementarities offered by the firm.

Market-oriented ecosystems in the low-income segments

A market-oriented ecosystem is a framework that allows private sector and social actors to act together and create wealth in a symbiotic relationship (Prahalad, 2005). In emerging markets, market failures are common and so firms and investors face higher uncertainty and risk (Hoskisson et al., 2000). These “institutional voids” (Khanna & Palepu, 1997) constrain a firm’s growth (Peng & Heath, 1996). For this reason, academics have repeatedly emphasized the need to build institutional capacity to attract foreign direct investment to developing countries (Hoskisson et al., 2000; Meyer, 2001). While this is obviously a reasonable demand, it is also true that developing countries are dual economies with high disparities between high and low-income segments (Stiglitz, 2002). This means that institutional systems within developing countries are not homogeneous and can even be divergent (London & Hart, 2004). In this context, firms competing in low-income markets should build their own transaction ecosystem, rather than waiting for the institutional system to evolve through a “Western-style” institutional context (London & Hart, 2004).

Our study shows that firms face challenging conditions when entering low-income markets. Lack of distribution channels, specialized intermediaries or systems to support business growth; scant regulations or systems to enforce contract compliance; asymmetries in access to information, and mistrust: these are fairly common features of ecosystems in developing countries. In some cases, firms may even find that there is no demand for their products, even though the products could solve certain problems (for instance, there may be no market for packaged milk in low-income segments, even though Tetra Pak’s aseptic technology can be a cost-effective solution for distributing milk while ensuring its safety and nutritional value). We found that most of the companies that are competing successfully in the low-income segment are building a market-oriented ecosystem to operate in those markets. In turn, this means developing a *transparent transaction governance capacity*, jointly with the constituents of the ecosystem (Prahalad, 2005). That transaction governance capacity is not an *internal* capacity of the firm, but a capacity of the ecosystem. The role of the firm in this process is to help to build the capacity by training and educating across all levels so as to get responsible partners, by providing incentives to partners and other constituents, and by building a self-governance capacity (Prahalad, 2005). In **Table 2** we detail the activities carried out by CEMEX, Hindustan Lever and Tetra Pak that help to develop a transparent transaction governance capacity.

Table 2. Elements of a transaction governance capacity

Firm	Training and education	Incentives	Self-governance
CEMEX	A technical engineer advises homeowners in the construction process. Design and technical assistance helps homeowners to keep construction costs down by ensuring more efficient material use and professional quality construction.	By providing materials on a just-in-time system and maintaining a short construction timeline, the Patrimonio Hoy project has resulted in an almost 30-50% reduction in total cost for its clients. Distributors of construction materials are invited to participate in the project. Quality standards were defined. Participation in the project increased distributor sales by 20-25%. Community leaders and women who are already customers of PH act as promoters to inform potential customers about the characteristics of the project. They receive a coupon discount for each new group of customers attracted.	"Savings clubs" ("tandas") create a joint responsibility among contributors (typically three women per group).
Tetra Pak	Training of dairy farmers in sustainable farming. Information in schools about the nutritional benefits of milk	Capacity building and income generation for local actors (dairy farms and plants, and distributors). Local government and schools support the program because school attendance increases and health status is improved. Children have a big incentive to attend school and have access to high nutrition products.	
Hindustan Lever	A rural sales promoter visits 30 homes with the Shakti Amma in the first few months to teach her marketing and selling techniques. Awareness and education programs try to overcome some habits and attitudes and explain the benefits of using HLL's products (e.g., washing your hands with soap can avoid diarrheic diseases).	A typical Shakti entrepreneur conducts business of around Rs. 15,000 per month, which gives her an income in excess of Rs 1,000 per month on a sustainable basis. This almost doubles their past household income. In addition, it improves the social status of women in the community.	The symbiotic partnership between HLL and the Shakti Ammas creates a self-governance capacity that allows Shakti Ammas to build a self-sustaining cycle of growth.

These examples show that firms competing in unstable and underdeveloped market-oriented ecosystems are deepening ties and forming partnerships with local actors to create an ecosystem in which transactions can be performed efficiently. By working alongside local actors and partners, firms can obtain a competitive advantage based on the strong ties formed within the network. Patrimonio Hoy's general manager stated:

> "Competitors could not replicate our model because the credit system is based on establishing responsibility and commitment with customers. This requires an ongoing dialogue and collaboration with different people to build trust".

This means that developing a transaction governance capacity requires the participation of all the constituents of the ecosystem. Some activities are performed not by the firm, but by other constituents that have better network access or legitimacy. Therefore, the firm must be *embedded* in the ecosystem in order to gain access and have influence in the network. Accordingly, we formulate the following proposition:

Proposition 1: *The less well developed a market-oriented ecosystem is, the greater the need to develop a capability in social embeddedness.*

On the other hand, Nike and Star did not take any steps to build a transparent transaction governance capacity. While Nike failed in its venture –suggesting that lack of such a capability might be one of the reasons for the failure– Star was successful in some markets despite not having that capability. Therefore, we propose two more factors that may explain this contradictory result.

Psychic distance

Psychic distance means the degree to which a firm is uncertain of the characteristics of a foreign market (Johanson & Vahlne, 1977). As a rule, it is related to geographical distance and is influenced by differences of culture and language between the home and target countries. Cultural, geographic, and institutional barriers have been studied as a means of understanding the pattern of a firm's internationalization process (e.g., Johanson & Vahlne, 1977), entry-mode strategy (e.g., Kogut & Singh, 1988; Meyer, 2001), or even the flow of FDI between countries. Ghemawat (2001) developed the CAGE framework of distance to assess the risks of doing business in a new market; this framework considers four attributes: cultural distance, administrative or political distance, geographical distance, and economic distance.

At the same time, it has been argued that where formal institutions are weak (as in many developing countries), networks are widely used (Peng & Luo, 2000). In this case, theory suggests that joint ventures and strategic partnerships will facilitate market access and local knowledge (Hitt, Dacin, Levitas, Arregle & Borza, 2000; Kogut & Singh, 1988). Some studies have observed that firms with previous experience in internationalization and acquisition have acquired organizational capabilities that can moderate the importance of establishing joint ventures or developing networks (Barkema, Bell & Pennings, 1996).

In this study we add a new dimension to the concept of psychic distance. Traditionally, academics have used the term to refer to the uncertainty of entering a *foreign* market. However, our research shows that psychic distance is not limited to foreign markets but can also refer to the *domestic* country as well. For instance, as low-income segments have been traditionally ignored as a market, most firms are not acquainted with the characteristics of this market within their countries (customer's needs, habits and attitudes, informal institutional context, etc.). In this respect, CEMEX's General Manager for North America was quite clear:

> "We have to accept with humility that we need help because there are things that we don't know and don't even have the ability to explore".

For that reason, CEMEX put together a research team, who lived in Mesa Colorada –the city where the pilot project was launched– for one year and a half in order to understand the customers' needs and the local habits, traditions and institutions. For similar reasons, Hindustan Lever's marketing managers were required to spend two months living in rural villages before they formally took up their positions.

A foreign firm can substantially reduce its psychic distance if it has previous experience in low-income markets. For instance, Star was founded in 1937 in the middle of the Civil War in an impoverished Spain. For more than 40 years Spain remained poor and Star competed successfully in that market because it was able to develop a wide distribution network to deliver an affordable product that enriched the nutritional value of meals. As Star's General Manager in Kenya declares, the company's history has helped it to understand the competitive landscape in developing countries:

> "I imagine Kenya is what Spain was like a few decades ago. Distribution is not outsourced and if you want something done, you have to do it yourself, because no local company can do it".

Similarly, the first Tetra Classic package –Tetra Pak's first ever commercial product– was launched in 1952. Up until then, both milk and cream had been sold loose over the counter or in glass bottles. The fundamental idea was to rationalise the distribution of groceries by means of practical consumer packaging designed for ease of transportation. That scenario probably resembles the current situation in most developing countries.

These examples show how history and experience matter. Thus, when analyzing the concept of psychic distance in low-income segments we should bear in mind the firm's history and its previous experience in these markets. In **Table 3** we present the results, which afford some interesting insights into the relationship between psychic distance and social embeddedness.

Table 3. Relationship between psychic distance and social embeddedness

	New approach to psychic distance		**Level of social embeddedness**	**Venture results**
	Psychic distance	**Previous experience in low-income markets**		
CEMEX	Low	Low	High	Success
Tetra Pak	High	High	High	Success
Hindustan Lever	Low	Low	High	Success
Star – Kenya	High	High	Middle	Success
Star – China	High	High	Low	Failure
Nike	High	Low	Low	Failure

In light of these results, we propose the following conditions and consequences: 1) firms with a *high psychic distance* and *low experience* in low-income markets may need a high level of social embeddedness in order to succeed; 2) firms with *low experience* in low-income markets may need a high level of social embeddedness in order to succeed; 3) *High experience* in low-income markets can moderate the effect of psychic distance and thus the need to develop a capability in social embeddedness.

These results are fairly consistent with the previous literature. Networks and ties are extensively used to make up for institutional voids in underdeveloped markets (Khanna & Palepu, 1997; Peng & Luo, 2000). However, as some authors have observed, previous internationalization and acquisition experience allows firms to acquire organizational capabilities that can moderate the importance of establishing alliances or developing networks (Barkema et al., 1996).

Following this logic and the results obtained, we make the following proposition:

Proposition 2: *The greater the psychic distance between the firm and the host country, the greater the need to develop a capability in social embeddedness; however, previous experience in low-income markets can moderate that need*.

Product complementarities

In a seminal article, Prahalad and Hamel (1990:81) describe the competitive advantage of the corporation as "the ability to build, at lower cost and more speedily than competitors, the core competencies that spawn unanticipated products". Similar reasoning is proposed by Zott (2003), who adds speed in *learning* to develop new resources as another important attribute on which competitive advantage is based. Accordingly, new business development is based on the firm's core competencies, which drive the development of core products, which may need to be adapted to fit local tastes and preferences in each market (Prahalad & Hamel, 1990). These arguments have an implicit assumption: that the markets are homogenous enough to globally transfer the core competencies developed by the firm.

While this may be true in most cases, we have observed that in low-income segments a firm may, in some circumstances, offer an integral service rather than a single product. This requires offering a set of *product complementarities* (training activities, finance, education programs, technical assistance, etc.) that are not part of the firm's core activity, so the firm does not have either the capability or the knowledge to deliver them efficiently. In these circumstances, as the company moves away from its traditional activities and core competencies, the need to be embedded in a network is more evident. By identifying the right partners and people and developing a trustful relationship with them, a firm can use the knowledge and capabilities in the network (Gulati, 1999) to offer its integral service cost-effectively.

For instance, Tetra Pak's business model in low income-segments (Food for Development Program) is focused not only on selling processing and packaging machinery to dairy plants, but also includes other activities performed by different actors, such as training for dairy farmers, equipment financing, management support and training, market development and distribution system, consumer education campaigns, and waste management programs. Similarly, CEMEX's business model goes beyond the selling of cement to include financing, technical assistance, delivery services and promotion campaigns. All these activities could not be performed without the involvement and commitment of customers, the local community and distributors. Also, Hindustan Lever's partnership with Self Help Groups starts with enterprise and marketing training for Shakti Ammas.

By contrast, Nike and Star do not offer any product complementarities. They simply sell their core products. Nike used its core capability in product design and manufacturing to launch a low-cost sports shoe. Star has transferred its technological capabilities to manufacture its products worldwide and has built distribution channels using its experience.

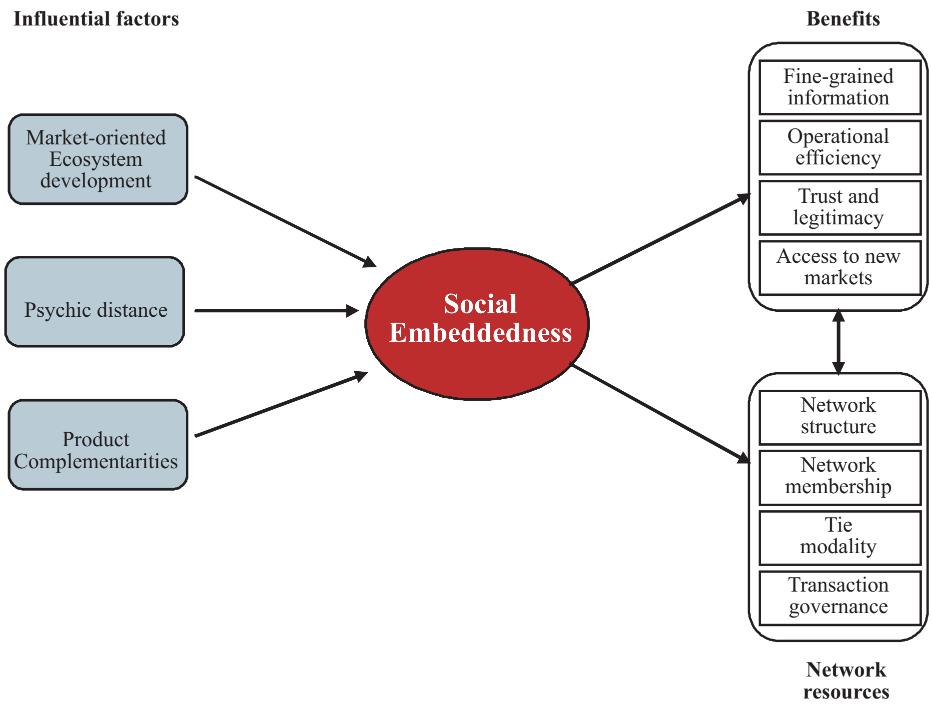
We observed that the need to offer product complementarities depends basically on product characteristics. If the product is simple, low-priced and is an upgraded version of an existing product, it can be sold without any complement. However, if the product is technology-intensive, high-priced and new to consumers, it will be necessary to offer some complementarities in order to make it affordable and accessible.

Proposition 3: *The more product complementarities the firm offers, the greater the need to develop a capability in social embeddedness.*

Benefits and network resources

So far, we have explained the antecedents or factors that may explain why a firm should develop a capability in social embeddedness when entering low-income markets. However, what are the benefits of having such a capability? A capability in social embeddedness can be understood as a *first-order capability* that gives access to certain benefits and resources which lie in the network the firm has formed. Therefore, a firm's network allows it to access key resources from its environment (Gulati et al., 2000), which is especially critical in low-income markets. In what follows, we shall detail the main benefits and network resources a firm may obtain by developing a capability in social embeddedness. **Figure 1** shows graphically the framework derived from our analysis

Figure 3. Antcedents and consequences of developing a capability in social embeddedness



Benefits

Uzzi (1996) states that embedded ties perform unique functions and have three mutually reinforcing features: trust, fine-grained information transfer, and joint problem solving arrangements. In our study we confirmed that trust and fine-grained information transfer are common benefits obtained by firms embedded in a network. We also identified two other benefits: improved business model operational efficiency (to some extent, this can be seen as a variant of Uzzi's "joint problem solving arrangement"), and access to new markets. **Table 4** shows the specific benefits obtained by the firms in our sample that had a high level of social embeddedness.

Table 4. Benefits from embedded ties and partnerships

	Fine-grained information	Operational efficiency	Trust and legitimacy	Access to new markets
CEMEX	• By engaging with different groups and potential customers in the local community, CEMEX identified the financial, technical and delivery problems that faced the do-it-yourself homebuilding market. • The strong ties maintained with customers (in fact, they were called "partners") resulted in an on-going improvement of PH's business model.	• The partnership with Ashoka helped to reduce the costs of setting up new branches because local entrepreneurs can more easily reach the local community and increase the customer base in a shorter period of time.	• The "co-responsibility" model of financing helped to build trust among all parties. The technical assistance offered by the firm also helped in this respect. • By engaging community leaders, the project gained more credibility. • Partnerships with Ashoka and Sedesol (government) added legitimacy and credibility to the project.	• The know-how acquired as well as the partnership with Ashoka and The World Bank helped CEMEX to expand the project more rapidly to new regions of Mexico.
Tetra Pak	• By involving relevant authorities and NGOs, Tetra Pak's program directors identify the outcomes to be achieved and design the project accordingly. • By engaging with different local agents (schools, local NGOs, and governments), Tetra Pak is able to offer a package that addresses local needs in terms of size and design. • Dialogue with local communities and schools allows Tetra Pak to implement a responsible solid waste handling system based on community needs and values.	• The network of partners established in each case is essential for implementing the program and supporting market development across the value chain. Each partner has a different role (e.g., distribution, training, information campaigns, etc.), allowing the program to be implemented cost-effectively.	• The involvement of local authorities, NGOs, and schools gives the project total support from the community.	• Long-term partnerships with aid agencies, international bodies and national governments give access to grants, funds, and loans for expanding "Food for Development" programs internationally.
Hindustan Lever	• The partnerships with MART (a marketing company), regional governments and local NGOs have provided information about where best to implement the Shakti project. They have also provided valuable information to identify the best Shakti dealers. • Strong ties with Shakti dealers give HLL a better knowledge of consumer demands and needs.	• The Shakti project has been designed to reach rural markets in a cost-effective way. Shakti Ammas are encouraged to launch their own marketing initiatives to extend their customer base. • More than 130 local NGOs support the Shakti project. They are interested in extending the Shakti initiative amongst their Self Help Groups in different states. This collaboration helps HLL to reduce the cost of setting-up and expanding the Shakti project in new areas. • Local NGOs and regional governments have extended education programs through schools, hospitals and communities.	• By implementing a door-to-door selling system, a closer and more human relationship is established.	• A variety of partnerships with regional governments, local NGOs and Shakti Ammas have given HLL the legitimacy it needs in order to access and enter rural markets.

Trust is an important asset for operating in any context. The embeddedness argument stresses how concrete personal relations and structures (or networks) of relations help to generate trust and discourage malfeasance (Granovetter, 1985). Traditionally, alliance governance has been based on transaction cost economics and opportunism because of the "appropriation concern" (Williamson, 1975). In contrast, the social embeddedness argument proposes an alternative method of governance based on close ties between firms and actors (Granovetter, 1985; Uzzi, 1996). Trust creates self-enforcing safeguards in an exchange relationship and can be a substitute for contractual safeguards (Gulati, 1998). In fact, in social capital, trust seems to be key to collaboration, which consists of transactions arising out of mutual obligations (Murdock & Bradburn, 2005). As we have observed, because formal contracts are rare and the ability to enforce them is weak, gaining trust is especially important in low-income markets, where market institutions are underdeveloped and social relations are very important. At the same time, we saw that, in order to obtain trust, firms cultivate long-term *cooperative* relationships with their partners and other actors. It is also common to see firms engaging with prominent, high profile parties that are trusted "institutions" in their local community (e.g., community leaders, local entrepreneurs, local NGOs, regional governments, etc.) to hasten the acquisition of the necessary legitimacy and trust to operate in these markets.

As we have already stated, low-income markets are largely unknown for most firms. Obtaining fine-grained information about the institutional and competitive context is therefore essential for developing a business model. Research on embedding has emphasized the informational and learning benefits that networks can provide (Gulati, 1998; Uzzi, 1996). Indeed, we observed that one of the main motivations for forming alliances and partnerships was to widen the organization's access to a variety of sources of knowledge. By doing this, firms were able to understand the social context and customers' needs, identify new business opportunities, detect the best partners for developing the project, or know the desired outcomes.

We also observed that embeddedness can enhance the operational efficiency of the business model. By establishing relationships and partnerships, firms can overcome the barriers and constraints they commonly face in low-income markets, where there is no institutional infrastructure or specialized intermediaries to support business growth (Khanna & Palepu, 1997; Meyer, 2001). To some extent, we observed that firms with a high level of social embeddedness developed networks which helped them to fill those institutional voids. As can be seen in Table 4, the network can be used to make the distribution system less costly and more efficient, improve the local partner selection process, and carry out marketing activities more effectively.

Finally, we identified a fourth benefit of embeddedness: access to new markets. Although this does not apply to all firms, we found that in some cases having prior ties with influential actors can favor access to new markets.

Network resources

The concept of network resources was proposed by Gulati (1999). It can be understood as the concept of social capital but applied to firms. Network resources do not belong to firms but to the interfirm networks in which firms are located. They can influence strategic behaviour by altering a firm's opportunity set. They are the result of unique historical experiences and unique path-dependent processs (Gulati, 1999). For all these reasons, a firm's networks and the resources they make available can serve as a source of sustainable competitive advantage.

The network resources most commonly identified in the literature are: network structure, network membership, and tie modality (Gulati et al., 2000). In our research, we effectively observed the presence of these three resources and identified a fourth that is especially critical in low-income markets: a *transparent transaction governance capacity*. Let's review the characteristics of these network resources in the low-income market.

First, the network structure is normally *non-hierarchical*, which allows social networks to develop based on a common set of shared values and beliefs. Second, the firm always plays a *central role* in the network because it is the firm that starts the project and connects all the other actors, filling the structural holes of the context (Burt, 1992). Its central position in the network inhibits and locks entry by competitors. Third, ties among partners are *strong and cooperative*, enabling the transfer of tacit and complex knowledge (Hansen, 1999). Fourth, we observed that the *transparent transaction governance capacity* can be categorized as a network resource because it requires the participation of all the constituents of the ecosystem, i.e., of the network. It allows transactions to take place among actors in the network and overcomes barriers due to the lack of formal contracts. To develop this capacity, we observed that the firm should act as a *nodal firm* that facilitates the functioning of the network as a whole (Prahalad, 2005). A firm's legitimacy and central position in the network allows it to influence the network without owning it, a feature that Prahalad (2005) considers especially relevant in these markets: "Ownership is not the issue. Access and influence without ownership are more important factors […]".

In sum, this study suggests that a firm's idiosyncratic networks are difficult to imitate and substitute. Thus, a capability in social embeddedness can help to secure network resources that may be a source of sustainable competitive advantage.

Discussion

This study is based on a multiple-case inductive analysis of business ventures in low-income markets and the development of embedded ties and partnerships in this context. The emergent theoretical framework explains the antecedents and consequences of developing a capability in social embeddedness. We find that if a firm enters an underdeveloped market-oriented ecosystem, has a high psychic distance from low-income markets, and offers many product complementarities, it should develop a capability in social embeddedness in order to succeed. We observed that if one of these conditions is not met, the need to develop such a capability decreases. Finally, we also found a set of benefits – information, efficiency, trust, and access to new markets– and network resources –network structure, network membership, tie modality, and transparent transaction governance capacity– that a firm can obtain if it is embedded in a network. Together, these findings make the contributions described below.

Our theoretical framework offers new insights to the embeddedness literature by specifying the value of embedded ties in low-income markets. Besides confirming the results obtained by Uzzi (1996) and Gulati et al. (2000) (namely, that embedded ties provide trust, fine-grained information transfer, and joint problem solving arrangements, or "operational efficiency", as we have called it in this paper; and that strategic networks are a source of network resources), we also found new benefits and new network resources (access to new markets; and transparent transaction governance capacity). It is also worth stressing that embeddedness in low-income markets it is not restricted to interfirm relationships or alliances, but includes ties between firms and other actors (NGOs, governments, local communities, customers, etc.).

It is important to highlight the importance of trust in these markets. Trust is a basic precondition for deep embeddedness in a network. It is a key asset obtained by building social relations with local actors at different levels. At the same time, trust can act as an alliance governance mechanism, abolishing the need for hierarchical structures and detailed contracts. Alliance governance in low-income markets is thus driven not by fear of opportunistic behaviour, as suggested by transaction cost theory, but by a desire for cooperation that emphasizes the role of embeddedness and trust, which also can make behaviour predictable (Gulati, 1998). Indeed, we observed that networks in low-income markets are normally non-hierarchical structures with cooperative ties, allowing for long-term collaboration. The cases of CEMEX, Tetra Pak and Hindustan Lever show that these aspects are especially relevant in low-income markets for three reasons: 1) The institutional context in poor regions is characterized by highly interdependent ecosystems in which social capital is very relevant, as it gives each actor access to other actors' assets and information. Thus, a firm can access other firms' or partners' know-how, and together they can use their knowledge to produce something that is of benefit to them all (Uzzi, 1996). 2) In low-income markets, transaction costs are high, whereas social networks can mitigate those costs by making opportunism more costly because of reputational effects (Gulati et al., 2000). As we observed, the transparent transaction governance capacity makes it possible to carry out transactions effectively. 3) With the emergence of an ecosystem, firms can gain network advantages by supplying the critical ties that are missing in the system. Approaching and embedding partners early in the market gives the firm the opportunity to approach prominent partners to *co-create the market* (Ozcan, 2005). These results suggest that early tie formation in low-income markets can be a source of competitive advantage.

At the same time, we can also offer some contributions to the international strategy literature and the theory of the multinational firm. According to our results, the internationalization process in low-income markets is best explained through the lenses of the dynamic and evolutionary models of the multinational firm (Kogut & Zander, 1993; Nelson & Winter, 1982). In that light, competitive advantage is dynamic, based mainly on the ability to create –not to exploit– capabilities. This implies the extensive use of joint ventures and alliances to prospect for new knowledge rather than focus on complete ownership to protect old knowledge (Tallman, 2001). Our examples effectively show that while some assets and capabilities are leveraged to compete in low-income markets, successful firms have also developed new capabilities to serve and compete in these markets.

In a conceptual dimension, we would like to point out the new definition proposed in this paper of the concept of psychic distance. While traditionally this concept has been considered mainly in relation to geographical, administrative, political and cultural distance, we suggest adding a new dimension based on the firm's experience in serving different income levels. We observed that a domestic firm can have a considerable psychic distance to overcome when entering low-income markets in its home country if it has never served that segment before. Conversely, the psychic distance a foreign firm has to overcome when entering a low-income market is substantially reduced if it has served that segment before.

Finally, in a more managerial dimension, embedded ties and alliances seem to be especially useful for distribution and marketing –including market research. Moreover, the companies that have developed completely new and different business models have had the direct collaboration of local parties in that process. This confirms that the bottom-up approach contributes positively to the development of innovative business models that are capable of serving the needs of the poor (Hart & Christensen, 2002).

Conclusion

Whereas neoclassical accounts focus predominantly on asocial and price-determined allocative mechanisms of exchange, the structural embeddedness approach emphasizes how social networks achieve outcomes that may match or surpass market alternatives (Uzzi, 1996). As we have seen throughout this paper, this is especially true for underdeveloped market ecosystems. Considering that the central premise of social capital is that social networks have value, this paper attempts to provide a first approach for assessing the *value* of embedded ties and strategic alliances (with traditional and non traditional partners) in low-income markets. In this study we have identified the main benefits and resources a firm can obtain by developing a capability in social embeddedness. At the same time, we have described the main factors that condition the need to develop this capability. From our results, we have observed that this capability is not always necessary for success. However, as network development contributes to the building of capabilities beyond firm boundaries, firms that have developed this capability may be able to create more total value –social and economic– and have a greater positive impact on their social context than those that have not developed it. Given the critical importance of total value creation in low-income markets, this is an important avenue for future research. Some aspects require further examination, such as: What characteristics of a firm make it more likely and better able to develop a capability in social embeddedness? What are the main sources of value creation? How can the total value created within and outside the organization be assessed and measured? Is there any positive relationship between social embeddedness and performance? By responding to these questions, the literature of strategy in low-income markets will be able to better understand the conditions for gaining competitive advantage in these markets while contributing to the development of poor areas.

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