DAIdeas

Innovation in action

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Pyramids, Profits, and Poverty Reduction

For every business, the one item that never leaves the agenda is the search for the next big growth opportunity. Yet how often do large, multinational corporations look to the developing world for that prospect? And how often do the poor in developing countries look to multinationals for products and services to improve their lives? Perhaps surprisingly, the answer is more and more often.

Moving Beyond CSR

We stand in the midst of a major shift in international development, in which international private capital and private enterprise are replacing international public capital and aid as the dominant resources. These new private sector players may take us much further in alleviating poverty and improving livelihoods—but only if they appreciate the opportunity at hand.

For years, corporate involvement in developing countries and emerging markets focused on exploiting key resources (natural and human). Extract the resource, make the product cost-effectively, and sell it where people have more money . . . that was the mantra. Firms kept their public profiles low, made quiet, individual deals with governments to support local operations (sometimes facilitated by quiet diplomacy), and avoided extensive involvement with local institutions and societies.

Over time, this "stick to the knitting" approach led to dissatisfaction both in-country and back home, prompting a second phase in corporate development strategy: demonstrating philanthropic spirit. But initiatives such as building schoolhouses tended to be small, one-off projects with little if any relation to the core business and no concern for sustainability. Short-term image building was the focus.

Many corporations remain in this second phase. However, the last decade of the twentieth century saw a few move into a different kind of global citizenship, often through separate institutions such as foundations. A notable example is the Gates Foundation's work on HIV/AIDS, malaria, and tuberculosis. But such programs face concerns about their sustainability, and they too bear little relation to the companies' core businesses. Short-term impact on poor households is limited, as is collaboration and coordination among the firms involved, which in turn limits learning. CSR, or "corporate social responsibility," remains the dominant spirit of these ventures—not business, and certainly not profit.

Now, however, a small vanguard of companies is popularizing a radically different approach: seeing poor countries first and foremost as markets, and the poor masses first and foremost as prospective clients. "If we stop thinking of the poor as victims or as a burden and start recognizing them as resilient and creative entrepreneurs and value-conscious consumers," says the University of Michigan Business School's C.K. Prahalad, an advocate for this approach, "a whole new world of opportunity will open up."[1]

Evolving Corporate Roles

Extraction & Exploitation	→	Social Responsibility & Global Citizenship	→	Mutual Profit & Maximum Benefit
pre-1990		1990-2000		post-2000

[1] *The Economist*, August 21, 2004. See also C.K. Prahalad, *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits.* Saddle River, N.J.: Wharton School Publishing, 2004.

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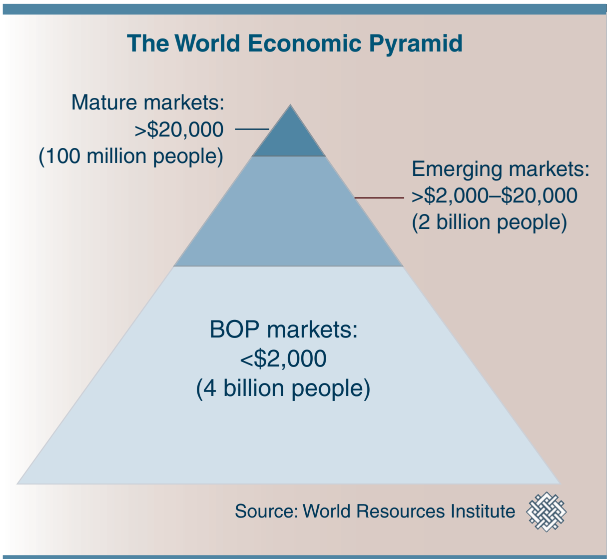

The new vision seeks to make the corporation's business a vital part of local economic development by providing key products, services, and upstream and downstream opportunities for local entrepreneurs. In this vision, the corporation's development work is integral to its core business, generating short-term impact in-country and mutual profit. Interestingly, this new approach may generate maximum returns when implemented with other large international firms.

DAI embraced this business-driven approach to corporate engagement many years ago. From our earliest overseas projects in the 1970s, we sought to involve large corporations in mutually profitable engagements with small farmers and artisans. We have encouraged commercial bank involvement in the profitable delivery of financial services to poor households for almost as long. This is why we are partnering with the World Resources Institute (WRI) to support a major conference on private sector approaches to international development. Also backed by Microsoft, Hewlett-Packard, Vodafone, SC Johnson, ChevronTexaco, and others, *Eradicating Poverty Through Profit* will take place December 12–14 in San Francisco.

The conference will show the private sector how it can "do well and do good" at the same time, as exemplified in case studies from business sectors including financial services, consumer goods, agriculture, information and communication technologies, and natural resources. Working sessions will feature multinational corporations, businesses based in emerging markets, social entrepreneurs, civil society, and bilateral and multilateral agencies.

WRI's innovative market analysis nicely complements DAI's project experience in demonstrating the potential of business-driven corporate engagement in emerging markets. According to WRI, most of the buying power in developing countries—perhaps $1.7 trillion per year spread over 680 million households in 18 countries—is located at the "bottom of the pyramid" (BOP). Companies that ignore this base of the economic pyramid will fail to reap the full potential of the global market. *Eradicating Poverty Through Profit* will demonstrate how companies are tapping this potential, present successful business models replicable in diverse environments worldwide, and show how these profitable businesses reduce poverty.

The financial services sector has several outstanding examples of building strong businesses to serve BOP markets. Case in point: the dramatic transformation of the Agricultural Bank of Mongolia.

Khan Bank: A Study in BOP Opportunity

With a per capita GDP of only $430, Mongolia certainly is not rich, but it is showing signs of economic promise. Fixed line and mobile telephone use jumped from 48 to 141 per 1,000 people between 1998 and 2002, for example (World Bank Group, Mongolia Data Profile, 2004). The banking sector has also found good profits to be made in providing Mongolians with basic financial services—although it took a bankruptcy to learn the lesson!

After many years of operating deficits, loan losses, and a failed privatization, Mongolia's Ag Bank (now more commonly known as Khan Bank) was placed in receivership in 1999. Many in the international community felt the bank should simply be written off as unsustainable and closed, but the political and economic significance of the institution earned it a reprieve. The only bank with branches throughout Mongolia to transfer money, make government pension and salary payments, and accept deposits, it was and is the only source of financial services for rural Mongolians, roughly half the population.

The Government of Mongolia decided to recapitalize Khan Bank with assistance from USAID and the World Bank, and to install new management that would develop a more viable business strategy. In July 2000, DAI contracted to manage the bank with a mission to restore financial soundness, bring financial services to the rural population, and prepare the bank to operate independently and be privatized.

Table 1: Khan Bank Loans (as of February 2004)

Loan Product	Date Product Launched	Total No. of Loans Disbursed	Total Value of Loans Disbursed ($000s)*	Total No. of Loans Outstanding	Total Value of Loans Outstanding ($000s)*	Average Loan Outstanding ($)
Micro & Small	Nov. 2000	80,835	98,780	13,485	19,135	1,419
Small & Medium	May 2001	3,300	15,555	1,633	8,184	5,011
Pensioners	May 2001	628,431	36,912	72,277	5,003	69
Herders	Aug. 2001	31,373	20,753	9,449	6,819	722
Payroll Based	Oct. 2001	132,784	34,177	30,539	6,654	218
Crop	May 2002	1,483	746	148	89	604
Mortgage	April 2003	770	3,752	696	3,144	4,518
Total		**878,976**	**210,675**	**128,227**	**49,028**	**382**

Table 2: Khan Bank Deposit Evolution (converted to US$000s)*

Deposit Category	12/31/03		12/31/02		12/31/01		12/31/00	
Businesses	9,730	13.2%	9,798	22%	8,117	33%	3,663	28%
Government	4,293	6.7%	8,207	18%	8,570	35%	6,712	52%
Individuals	50,225	80.1%	27,028	60%	7,752	32%	2,520	20%
Total	**64,248**	**100%**	**45,033**	**100%**	**24,439**	**100%**	**12,895**	**100%**

* Note: Most loans and deposits are in the local currency, tugrug, and converted here to U.S. dollars at the current exchange rate of 1,174.

The management team developed a new lending program focused on the specific demands of the bank's customers, converted payment services into deposits, developed a marketing program to improve the bank's image and attract clients, implemented strong controls, improved the management structure, and increased training. Within a year, Khan Bank's operations were in profit. Pre-tax profits grew to $300,000 per month in 2003, and its return on equity (44 percent in 2003) made it the most profitable bank in the country—all based on serving the BOP market.

Khan Bank now has 379 points of service, many more than any of Mongolia's other 16 banks (and up from 269 when new management took over). One of every two Mongolian households today is a client of Khan Bank. These and other statistics in the tables above demonstrate that profit lies in high-volume, low-margin services: the average deposit account is only $200, the average loan only $382, and the average domestic money transfer only $16.83—but the bank handles 15,400 transfers per month. In short, the bottom of this pyramid is a very solid foundation for business.

The acid test for Khan Bank came a year ago, when the Government of Mongolia put it up for sale and received three viable bids, all from strong, fully qualified private sector parties. H.S. Securities of Japan—a commercial investment firm—purchased Khan Bank for US$6.85 million, not out of any sense of social responsibility, but because it saw a good deal that extends its presence into a new market tapping hundreds of thousands of new customers.

Just the Tip of the Iceberg

The provision of mass-market financial services, as exemplified by Khan Bank, is only one of many ways the financial sector can make money while serving the global good through BOP initiatives. To take just a few examples from DAI's direct experience:

Private credit information services for emerging markets. Major international credit bureaus are discovering substantial markets for their services in poorer nations. One bureau in the Dominican Republic is processing 600,000 credit information requests per month. At $1 per request, that is both serious business and a doorway through which many poor entrepreneurs finally get access to bank loans. DAI has helped introduce new credit bureau operations in Ecuador, where one operator has amassed 350 clients after only a short period of operations and expects clients to exceed 2,500—demanding 250,000 reports per month—by 2006.

Improving remittances services. More than $80 billion per year flows from the expatriate diaspora to families in their home countries (in officially tracked transfers), far more than official foreign aid. Improving these international money transfer services and broadening investment options for recipients represent a huge and untapped market that Western Union, VISA, and others are now beginning to address.

The South African Financial Sector Charter. Motivated by social as well as economic imperatives, South Africa's financial institutions agreed on targets for improving their services to local mass markets. Taking the Government of South Africa's economic agenda into their own hands, they committed by 2008 to provide 80 percent of the poor majority with basic transactions products (money transfers, salary deposits, and so on)[2] and with basic savings services; they also agreed on similar targets for life insurance, short-term risk insurance, and other financial products for the poor. The sector also agreed on indicators to measure progress and combined these into a "scorecard" to rate each institution's performance.

Opportunity, Imperative, or Both?

Khan Bank and other ventures show the enormous potential of BOP markets. And as Allen Hammond of WRI and C.K. Prahalad point out, serving BOP markets is probably more than a market opportunity—it's a market imperative: "Blocs of poor consumers increasingly have the power to reject what a multinational corporation wants to buy or sell. . . . It may not be wise for corporations to wait for governments to smooth the path of globalization, or to depend solely on formal trade talks to make developing markets safe for their products."[3] Instead, they should innovate in their product and service lines to overcome the constraints that limit access to BOP markets and assimilate the lessons of Mongolian and similar experience, or risk losing out to competitors that embrace these new business models.

[2] The charter defines this "poor majority" by the standards set out in the South African Advertising Research Foundation (SAARF) Living Standards Measures (LSM). The targets refer to people from households in LSMs 1-5, which in 2002 accounted for more than 65 percent of all households and represented households with monthly incomes of less than ZAR 2,230 (approximately US$225/month). Data from SAARF presentation, September 2002.

[3] Hammond and Prahalad, "Selling to the Poor," *Foreign Policy*, April/May 2004.

Questions? Comments? Contact daideas@dai.com

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