Socially Inclusive Business

Engaging the Poor through Market Initiatives in Iberoamerica

A Collaborative Research Project of the
SOCIAL ENTERPRISE KNOWLEDGE NETWORK

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Ezequiel Reficco
Gabriel Berger

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Contents

List of Figures

List of Tables

1

Introduction: A Fresh Look at Markets and the Poor

Patricia Márquez, Ezequiel Reficco, and Gabriel Berger

Marcela made a living gathering wild fruit and mushrooms in Chile's Bio-Bio area, the country's second poorest region. The job itself was disparaged, left to women and children. Marcela's meager earnings from selling highly perishable produce to middlemen barely provided subsistence. Her shack lacked running water and electricity. In 2000, the non-profit Taller de Acción Social (TAC) began training and organizing local collectors; eventually, fruit gatherers began dealing directly with the produce companies, and the way their occupation was perceived by the rest of the community changed for the better. Four years later, 70 families had joined in an organization, with gatherers drawn from eight local communities. Soon enough they learned that dehydrated produce sold for higher prices and began to process fruits and mushrooms that way. Today they only sell dehydrated produce.

In 1998, Jose left his shanty just outside Morelia, the state capital of Michoacan, in Mexico, to join relatives in California. There he got a job demolishing cars, while saving all he could in hopes of building a new house for his family in Morelia. Six years later Jose heard of Construmex, a program launched by Cemex to sell cement and home improvement goods to the poor in association with local distributors offering credit terms in towns across Mexico. A Construmex architect designed the blueprint for the house and, after two years, Jose's family had a three-bedroom home with two bathrooms, living room, and kitchen.

What both Marcela and Jose sought—higher income and dignity and a home to return to, respectively—was made possible by business-generating market initiatives that turned the poor into consumers, producers, and business partners. The idea that market mechanisms can mobilize social change by engaging the poor in win-win scenarios is gaining increased world attention. Companies, civil society organizations (CSOs), and development agencies are all beginning to glean the potential to be gained from energizing the human capabilities that lie among the billions of the world's poorest people.

Behind this newly found interest in markets lies the realization that any effective response to global poverty will have to meet three fundamental characteristics.[1] First, it will need to have **scale**. The sheer magnitude of the problems calls for solutions that can be scaled up or replicated to meet demand. Well-intended efforts of philanthropic agencies are unlikely to pass this test. Second, it will need to have **permanence**. Given the intractability of the problem, any serious effort will have to span generations, for governments come and go, and multilateral agencies change their priorities according to the agenda of the moment. Third, any solution to poverty would need to have **efficiency and efficacy**. Resources are scarce, and have to be stretched if we are to make the most out of them. Governments do have scale, but efficiency and efficacy is hardly their strongest suit. On the other hand, even the private sector's detractors concede its ability to deliver value to the point in which marginal benefits equal marginal costs. Managers may change, and companies may go bankrupt, but there are very good chances that resources will flow to serve any need that can be served profitably through a tested business model.

Yet for the private sector to become part of the solution to poverty will not happen spontaneously, or overnight. Historically, both private and public companies have failed to serve the poor in Iberoamerica. Even public utilities, chartered to serve all homes in entire cities, are known to have overlooked low-income consumers. Yolanda, in 1974, erected her shack on the edge of the El Junquito road, 9 kilometers outside Caracas, Venezuela. Along with other Kilometer 9 squatters, she tapped the nearest lamp post for free electricity—for the power company's policy required land titles to provide service to dwellings. Despite a precarious hillside location, over the years Yolanda added room after room to her shack in order to provide shelter for her children and grandchildren. In time, power service was so weak that Yolanda couldn't turn on her TV set while ironing clothes. By 2005, the power company, concerned over mounting power losses from illegal connections, offered Kilometer 9 community dwellers reliable service if the head of household showed an identity card and agreed to become a paying customer. But why did it take the company 30 years to do so?

The answer to this question lies in a host of geographical, socio-cultural, political, and economic issues that distance companies from people living in poverty, who in effect become invisible to the rest of society. Yolanda's shack was hardly isolated geographically, located as it was on the edge of a public road in plain view of passing traffic. Her case was hardly unique either; on the contrary, it was quite representative of the challenges that large swaths of Latin America's population face on a daily basis. To be sure, low-income sectors (LIS) have long participated in trade, but they often do so in a technological and organizational context of limited opportunity and multiple hurdles—even exploitation. Indeed, the poor must often pay higher prices than those with higher income for similar goods and services: the so-called poverty penalty.[2] Supermarkets offering the lowest prices, for example, are seldom conveniently located near poor communities; and poor consumers are rarely able to buy supplies for more than a day or two.

The results of traditional efforts to alleviate poverty have been rather disappointing, despite the massive resources invested in the last 50 years,[3] and this makes the investigation of novel or complementary approaches all the more urgent. In this book, the Social Enterprise Knowledge Network (SEKN) takes stock and assesses the progress made so far in fostering market initiatives with LIS in Iberoamerica. We look at how different kinds of organizations have engaged LIS communities from across the region in market-based initiatives, and analyze the outcomes of these processes. A task force drawing on 9 teams of researchers from various business schools and universities examined in depth a total of 33 experiences, to learn what is needed for building new business value chains that help move people out of poverty.

The first section of this chapter defines its object and the main research questions that guided our collective efforts. In the second section we place this study in the context of the existing relevant literature. We then shed some light on the population segments that have benefited from the initiatives analyzed: the poor and the socially excluded. The following section describes the sample and the roles performed by LIS in the various cases. Finally, we give an overview of the book's content, with a succinct summary of each chapter.

The "Business" of this Book

A fitting point to start is with the precise meaning of the book's title. In our study of "socially inclusive **business,**" we looked into business models that proved effective in connecting low-income sectors with mainstream markets and had the potential and the aspiration to improve the living conditions of the poor. This feature is what justifies the use of the term "inclusive" (which we will generally use henceforth)—as opposed to simply selling to the poor—in that it allows poor communities to take one step closer to mainstream markets and broader, meaningful citizenship.

Our collective research was guided by a common protocol of questions (see Annex, at the end of the book) seeking quantitative and qualitative information on three issue areas. First and foremost, we examined the organization that developed the venture, paying close attention to its business model. What kind of resources and capabilities need to be in place to make the connection with LIS? What kinds of barriers hindered that connection, and how were they overcome? Second, we analyzed the organization's milieu, and particularly the array of collaborative arrangements that sustained its business model. Given the magnitude of the challenges, solutions often require the engagement of various organizations, working together in pursuit of a common goal. What kinds of linkages between private, public, and non-profit sectors are built around these initiatives? Finally, we sought to assess the economic and social value created by the venture.

Business models are useful in providing blueprints that can be adapted and adopted. A business model defines how a new solution will create value for the client, and how the organization will capture some of the value in the form of profit. The analysis of the selected organizations' business models shed light on the way in which they (1) articulate a value proposition; (2) identify their market segment; (3) define the value chain required by the offering and the complementary assets required to support the organization's position within it; (4) specify the revenue-generating mechanisms, the cost structure, and profit potential; (5) position the organization within its setting (ecosystem), linking suppliers and customers, identifying potential complementors and competitors, and (6) establish a competitive strategy to gain and hold advantage over rivals.[4] In the initiatives examined, the business models were not always completely developed or even entirely clear to company managers, and our analysis aimed at making them explicit.

As we saw, these models were quite diverse; what they all had in common was that their ultimate driving force was the pull from demand, as opposed to other poverty alleviation approaches, based on the push that may emanate from grants or social investments, in top-down philanthropic or development programs.[5] Some push from mission-driven support organizations may be present, but these initiatives primarily aim at creating value for the end user of the value chain. The commercial dimension is what keeps them going. As defined here, market initiatives do not rule out the presence of targeted philanthropic or public interventions. As a matter of fact, these were a pervasive presence across the sample. However, they were either temporary or established by the regulatory framework and leveraged by entrepreneurs to externalize some of the costs implicit in building a new market. In all cases, the driving force behind the initiative's growth has been the connection of supply and demand.

The initiatives analyzed in this book found business opportunities in low-income sectors. All initiatives were part of the organization's core business—

although many of the sample cases were pilots, representing a mere fraction of the organizations' overall revenue. The cases were filtered through a double lens: *prima facie* they had to create economic and social value. The extent to which they succeeded is analyzed throughout the book, and particularly in chapters 9 and 10.

The word "business" in our title was not used to denote simply private companies. Our sample of market initiatives spanned 20 companies and 13 social enterprises that included cooperatives and civil society organizations (CSOs). Companies varied in size from multinational corporations (MNCs) to medium- and small-scale enterprises (SMEs); similarly, participating cooperatives and CSOs also varied in size.[6] A conscious decision was made to structure our inquiry upon the focal points of different organizational forms, for various reasons. While most the research focused on the BOP (Bottom or Base of the Pyramid) and inclusive business implicitly or explicitly emphasizes the potential of MNC in the fight against poverty, this approach would be somewhat out of line in a region where 90 percent of all productive organizations are micro-enterprises or small and medium enterprises (SME). Cooperatives have a rich tradition in the region, and many inclusive ventures made use of this tradition to build innovative business models, integrating the poor into vibrant value chains. Finally, most of Latin America's CSOs have stopped looking at the market as the root of the problem and started to embrace it as part of the solution in the fight against poverty alleviation. Public-sector enterprises, however, were deliberately left out of the sample. Undoubtedly, useful lessons could be drawn from public-sector market initiatives, but these are often subsidized on a continuous basis, which was inconsistent with the criteria that led our case sample selection.

The case set we selected does not pretend to be representative of the totality of inclusive businesses currently under development in Iberoamerica. Our selection meant to reflect variety in terms of organizational form, types of industries, and geographical scope. We also sought to make sure that the cases were balanced in the ways in which low-income citizens were engaged, such as consumers, distributors, or suppliers. Additional criteria included:

- The initiative must actively seek business opportunity with LIS;
- The initiative must prove significant for the organization, preferably as part of its core business (although the LIS initiative could represent a mere fraction of that business);
- The initiative had to generate economic value (EV) and social value (SV). The resources generated by the venture had to cover all factors of production as well as depreciation, administrative costs, and other

types of costs. For CSOs, EV was defined as *financial sustainability*; i.e., an organization's capacity to operate indefinitely. For private companies, EV required *profitability*; the initiative should be capable of creating value after repaying all factors of production—not simply their *cost*, but also their *opportunity cost* (the most valuable forgone alternative). As working definition for SV, we adopted the one forged in SEKN's previous book: "the pursuit of societal betterment through the removal of barriers that hinder social inclusion, the assistance to those temporarily weakened or lacking a voice, and the mitigation of undesirable side-effects of economic activity."[7]

In principle, cases in our sample had to be free of subsidies, with two exceptions: (a) subsidies could be acceptable in startup ventures, as a temporary resource with an expectation that in some foreseeable future the initiative could be either profitable or sustainable; (b) subsidies were also deemed acceptable when they were horizontal, that is, granted to an entire industry or sector by regulation, rather than channeled towards a specific initiative on an ad-hoc basis. Our primary unit of analysis was single organizations, or even subunits (those in charge of managing initiatives targeted to the poor). At the same time, we paid close attention to the interactions between the organization and its milieu. This was particularly important, as many of these initiatives were managed not by individual organizations, but by means of cooperative arrangements between various organizations. Thus, this is an embedded multi-case study: our primary emphasis was placed on the organizations that functioned as the "center of gravity" of the initiatives, determined its overall direction and articulated participant energies, but when needed the analysis was carried further out to encompass key partners.

Inclusive Business and the BOP Approach

In recent years, the pioneering work of C. K. Prahalad, Stuart Hart, and Allen Hammond on the concept of "serving the poor profitably,"[8] coupled with the widely shared view that development organizations failed to mobilize major social transformation, have triggered the emergence of a field of intellectual enquiry and practice known as the BOP.[9] This study seeks to make a contribution to that emerging literature. The initiatives analyzed here share some of the principles that define the BOP approach.

Connecting the local with the non-local. The possibility of inserting LIS in the global economy—"democratizing the economy," as Prahalad puts it—may provide a passkey to social transformation. All too often the poor are captives of unscrupulous middlemen, who benefit from LIS disconnection from mainstream markets. Usually the poor are underpaid as workers and overpay as consumers, as they do not have the benefit of multiple and competing bidders. Inclusive businesses connect supply (producers) with demand (consumers), and the local dimension with the global, thereby unleashing positive self-reinforcing processes of economic wealth creation and social empowerment.

Patient innovation. Most BOP scholars have signaled the need to tackle these ventures with a long-term view. Rather than considering the poor as the periphery of mainstream markets—the "next 20 percent"—that can be served through "business as usual," they should be considered as uncharted territory, an entirely different market. Those profound differences call for ad-hoc business models.[10] Much as what happens in the development of any new market of product line, the productive potential of the poor can only be unleashed through "patient capital": focused on the long run, willing to accept below-market returns at the beginning, and combined with assistance.[11]

The leverage of local assets. The BOP places a premium on the pragmatic leverage of the existing infrastructure. Albeit not ideal, its assets provide a useful starting point to start building a new institutional environment from the bottom up. Earlier BOP studies have shown that "in accessing low income sectors, the leverage of existing social organizations, networks and practices proved to be highly effective."[12] As Ted London points out, this approach marks a departure from traditional development models that focus more on building enabling environments from the top down, on a macro level.[13]

At the same time, however, our approach to inclusive business departs somewhat from mainstream, U.S.-inspired, studies of BOP. The differences are not fundamental, but they are nonetheless relevant to understand the precise purpose of this study.

Ventures' protagonists. The movement to utilize the market in the fight against poverty began as a call to action to multinational corporations:[14] for example, as one influential article suggested in its title, to employ "The Corporate Key: Using Big Business to Fight Global Poverty."[15] Prahalad's seminal work was based on the premise that multinationals corporations (MNCs) were best positioned to tackle the daunting task of truly alleviating global poverty, as they commanded the financial clout, global distribution channels, and brainpower needed to address the challenge. In fact,[16] even those early works counted among their cases ventures led by SMEs or

CSOs, but they were not acknowledged in the conceptual frameworks developed inductively from the experiences. Later formulations were broader,[17] but as of this writing BOP publications still place most emphasis on MNCs. While CSOs are considered important, they tend to be seen as "unconventional partners,"[18] not protagonists. The difference divides practitioners working in the field. For example, some support organizations, such as SNV,[19] concentrate on large companies in their BOP work, while others, such as Avina, include initiatives led by CSOs in their understanding of socially inclusive markets. In this regards, our approach is closer to that of social enterprise, open to the leadership of various organizational forms, than to the mainstream BOP literature.

The principle of external participation. Another constant in the BOP literature is the "principle of external participation," according to which BOP initiatives must be launched by "an exogenous . . . venture or entrepreneur," a "non-native" agent operating outside the informal economy where the poor live.[20] The external agent is at the center of the wealth-generating activity. It does not merely "assist" the poor, financially or technically: it is directly involved in the wealth-generating activities.

On this point too, this study purposely took a broader approach. As the rest of the book will show, external actors did play a key role in many of the initiatives studied. At the same time, many of those initiatives were self-centered efforts by the poor to strengthen and scale up their business models, through a combination of learning by doing with trial and error, and external advice and support. Whereas the traditional BOP model relies on exogenous actors who intervene through radically new business models,[21] in the social entrepreneurship model the native players are central. External organizations, such as MNCs, contribute by helping to remove bottlenecks (for example, providing distribution channels, technology, financial or technological assistance) and bring the initiative up to scale.[22] Thus, the approach followed to select the cases included in this study falls between the BOP and the "social entrepreneurship" models.[23]

Co-creation of ad-hoc models v. incremental adaptation. As a corollary of the principle of "external intervention" BOP scholars often posit that to be successful, solutions must be "co-created" by the exogenous actor and the poor. The model proposed is the combination of "knowledge developed at the top of the pyramid with the wisdom and expertise found at the bottom."[24] As London explains, this feature differentiates BOP strategies from traditional corporate strategies, which import existing business models into the BOP.

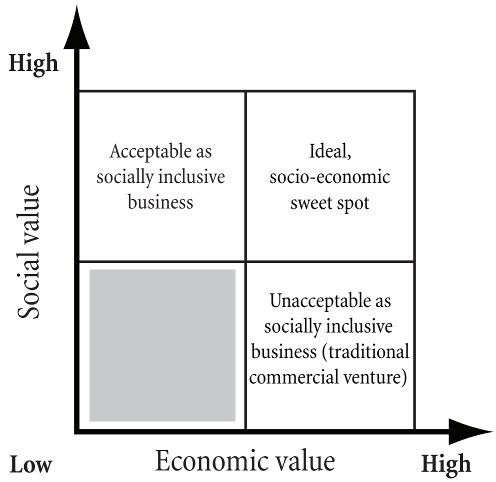
Here too, this study has taken a somehow different line. While the co-creation of value is desirable, and often achieved, it has not been considered a defining trait of socially inclusive market initiatives in this study. As indicated earlier, some of the ventures analyzed here were conceived and executed by the poor, denying the symbolic marriage between bottom and top of the pyramid at the strategic level. It should be noted that co-creation does not allude to technical or financial assistance, but rather to "pilot-testing, evaluating, and formalizing the enterprise in a collaborative and equitable manner."[25]

Co-creation appears in our sample, but we have also included ventures in which companies intervened unilaterally in low-income sectors through incremental adaptations of existing business models, which would not be considered legitimate BOP ventures in the terms outlined above. The rationale behind this decision by the authors is clear: to work with familiar business models that prospective readers could relate to and be inspired by. As has been noted, incremental change though the assembly of existing building blocks (in collaborative arrangements in which various organizations bring together their expertise) is more feasible than the creation of radically new business models.[26]

Self-financed growth and sustainable social value creation. The initial wave of writings on BOP was presented as an enormous untapped business opportunity: as a "fortune" to be made at the bottom of the pyramid.[27] Perhaps because the message was tuned to the ears of mainstream business people—as opposed to the mission-driven crowd of CSR (corporate social responsibility) officers, social entrepreneurs, or development professionals—the business case was heavily stressed. Later formulations of the BOP approach presented a more balanced picture, stressing the need to put in place "mutually beneficial economic and social incentives."[28] To some BOP analysts, it is essential that growth be fueled by self-generated profits for the venture to be scalable. In this view, economic and social returns go hand in hand, and mirror each other: "the greater the ability of the venture to meet the needs of the poor, the greater the returns to the partners involved."[29]

This of course, is the ideal of inclusive business: radically innovative solutions, delivered at a fraction of the cost of old solutions, and to great benefit to previously ignored customers or producers. In this study we have taken a more down to earth approach. We purposefully left aside initiatives that generated high economic returns, but questionable social benefits—such as selling carbonated drinks to the poor. At the same time, we willingly included in our sample self-sustaining ventures with limited profits, provided that they were economically sustainable and generated substantial social and environmental benefits.

Figure 1.1
Profits and Social Impact in Socially Inclusive Business



Who is to be "Included" in Inclusive Businesses?

After defining "business" in the context of this study, it is worth reflecting on the target of these efforts. Whom do we have in mind when we talk about the "poor" or LIS? Marketing studies that rely on socio-economic classification usually place this population sector in categories D and E—with high-income segments in A and B, and the mid-income group in C. However, it is difficult to pinpoint with precision the boundaries between these segments at the global level. In his seminal work, C. K. Prahalad defined the LIS category as those with an annual income of less than US$1,500 in purchasing power parity (PPP).[30] According to Hammond et al., the world's "base-of-the-pyramid" is comprised of the four billion people whose annual income is below US$3,000 in PPP.[31]

In Latin America, the task of defining with precision a region-wide poverty line is also problematic because of the heterogeneity of LIS income. As of 2006, it ranged from a monthly income of US$45 to 161 in urban areas, and US$32 to $101 in rural areas at current exchange rates. For people in extreme poverty, the range was US$21 to $81 in urban zones, and US$18 to $58 in rural zones.[32] The ventures in our case sample engage groups of both urban and rural poor, which feature marked differences. The urban poor generally lived in informal settlements—*barrios, favelas,* or *villas miserias*—and some live on the streets. Their main problems are crowdedness, everyday violence, insufficient basic services, and poor urban infrastructure. On the other hand, their spatial proximity facilitates social ties, an asset that was leveraged by many inclusive ventures. These urban dwellers also live close to some new technologies, such as mobile phones and the Internet, that permit increasing connection to national and global happenings. These features were capitalized in many inclusive business models.

Rural LIS challenges, on the other hand, include lack of access to basic services, insufficient infrastructure and cash scarcity, sometimes exacerbated by geographical dispersion and distance from urban centers. The rural poor tend to have less education and less access to information, basic services, and resources than their urban counterparts. They own fewer assets and generate low productivity.[33] For instance, in Brazil, 90.2 percent of the urban population has access to piped water, as compared with only 16.6 percent in rural areas.[34] In Costa Rica, 44.3 percent of the city dwellers have access to waste disposal systems, while only 5.4 percent of rural populations have such access.[35]

In contrast to Latin America, Spain has no absolute poverty as measured in absolute levels of per capita income, at purchasing power parity. However, 14 percent of the population lives in relative poverty, as defined by the OECD: those below a threshold set at half of the median income.[36] In Catalonia, Spain, there are around 1.2 million people in risk of falling below the poverty line,[37] such as former prison inmates, physically or mentally handicapped individuals, or women who are victims of domestic violence. Our case sample includes three ventures that dealt with relative poverty (see Table 1.1).

Table 1.1
Social Exclusion in Spain

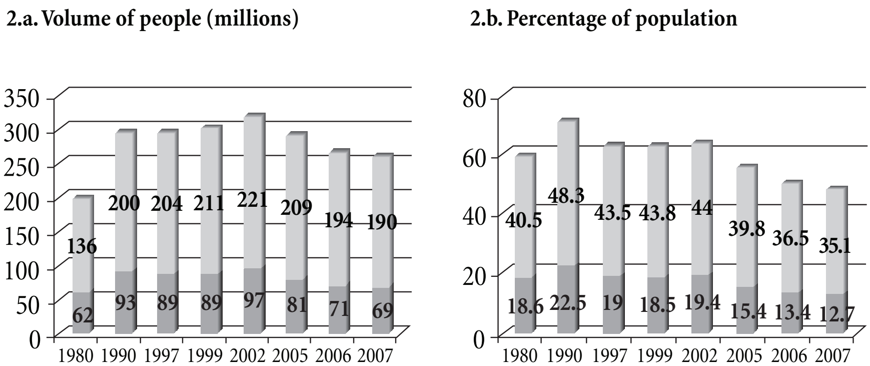
Organization	Targeted group
Andrómines	Gypsies, immigrants, women heads-of-household
Fageda	Handicapped
Fundación Futur	Ex prison inmates, immigrants, women heads-of-household, indigents

The definition of beneficiaries of inclusive business is further complicated by the fact that income deprivation is only one aspect of poverty. As

Amartya Sen has observed, poverty is complex and multi-dimensional, with such additional facets as inequality, informality, and exclusion.

Latin America suffers from huge inequality in the distribution of income. Although the overall number of poor Latin-Americans has diminished in the last 15 years, socio-economic inequality continues to be extremely high,[38] as measured by the Gini coefficient[39] which ranged from .44 for Venezuela to .6 for Brazil,[40] making Latin America the most unequal region of the world. It is clear to all that low economic growth generates poverty; the real problem is that the reverse is also true: poverty and low economic growth reinforce each other in a vicious cycle.

Figure 1.2
Evolution of poverty and extreme poverty in Latin America



Source: "Panorama social 2007 de América Latina," Comisión Económica para América Latina, 2007.

According to Latinobarómetro, over 70 percent of people in Latin America perceive income distribution as either "unfair"[41] or "very unfair." If perceptions of inequality and exclusion are not addressed, they can easily translate into social unrest and rising crime. Over time, this trend may worsen, leading to disenfranchisement and ultimately to political polarization. The longer such conditions persist, the greater the prospects of socio-economic conflict. Economic growth generally contributes to poverty reduction, but significant increases recorded in Latin America's economic growth during the 1990s accomplished little in this regard, and may in fact have widened income inequality.

Latin America also features high levels of informality: more than half of its labor force earns a living in the informal economy, with LIS likely to make up the largest share.[42] It is true that studies of successful informal economy business units, suggest significant opportunity for linking embryonic entrepreneurs with the formal economy,[43] as some of the recent research on entrepreneurship suggests.[44] This finding was confirmed by our research: several of the market initiatives examined in this study interacted with the informal economy. Workers active in the informal economy, however, often become more vulnerable to exploitation and poor working conditions, as the law and institutions scarcely protect them. In Spain, informality can be useful to understand poverty, as both tend to go hand in hand. Strong redistribution policies and public subsidies keep those "inside the system" out of absolute poverty, but those benefits do not reach people who remain in the shadows, such as illegal immigrants.

The LIS also suffer "social exclusion," a concept coined in the 1970s[45] to describe the crisis of the European welfare state.[46] In the context of Latin America, it can be defined as a "process whereby individuals and groups are denied access to opportunities."[47] Various barriers and restrictions prevent low-income citizens from becoming fully autonomous agents: chronic unemployment, insufficient access to basic services such as health or education, or race or gender-based discrimination.

Consider Venezuela's health services industry. On the one hand, the private sector delivers a quality service, but only 15 percent of Venezuela's population can afford it. On the other hand, public hospitals are chronically under-funded, lacking even the most basis supplies such as cotton, gypsum, or medicines. "Mandatory" social security insurance–co-funded by companies and workers—reaches only 14 percent of the population, in a country where informality is rampant. Net result: market research showed that 88 percent of respondents considered that they did not have any place to go to in case of a medical emergency. Can we really talk of an untapped "niche" or even a "segment" when we are addressing a basic, unmet need of 85 percent of a country's population? Such potentially explosive context surely shapes the perception of opportunities and risks of the private sector in the region. This reality was very much present in our minds as we designed and carried out this research project, and helps to understand why the poor were only recently "discovered" by companies.

LIS as Broad Economic Agents

Prahalad's pioneering research on the BOP urges businesses to view the poor not as victims or a burden on society, but as resilient and creative entrepreneurs and value-conscious consumers.[48] Experiences documented in Latin America substantiate this view.[49] In 33 market initiatives, LIS groups in Latin America and Spain played various roles.

The Poor as Consumers

Prahalad focused on LIS as potential consumers under-served by large companies, pointing out the revolutionary impact that broadening consumer choice could bring about for the poor in terms of economic growth and individual self-esteem. Obviously, the idea of "selling to the poor" as such was not exactly new. The radically new concept behind the inclusive business approach is that the private sector was now given a role hitherto assigned to governments, charities, or multilateral agencies. The prospect of making profits was for the first time linked with improvements in the living conditions of the poor. Later formulations then expanded the concept to encompass market initiatives led by other type of organizations.

Why would the market succeed where other efforts to reduce poverty had failed? The key to success lies in entrepreneurial and organizational capacity to shape models that can overcome long-standing economic, geographic, cultural, and social barriers faced by the poor, which limit access and affordability. In the course of our research we examined 15 organizations serving LIS as consumers with a wide array of products and services (Table 1.2). In four experiences (Activo Humano, Cruzsalud, Comunanza and Supermercados Pali) LIS were at the center of the organization's mission, while in the

Table 1.2
The poor as consumers in case sample

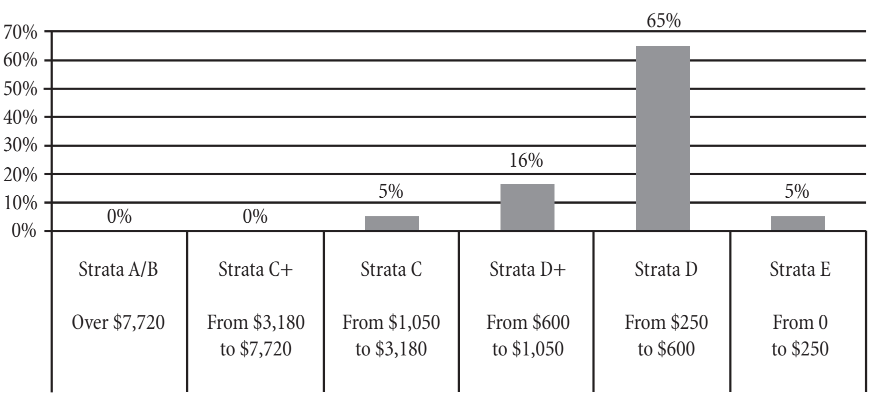
	Organization	Product/Service	Country
LIS as main focus	Activo Humano	Work placement	Chile
	Cruzsalud	Health services	Venezuela
	Fundacion Comunanza	Micro-finance	Venezuela
	Supermercados Pali	Perishable and non-perishable goods	Central America
LIS as peripheral focus	AES-Electricidad de Caracas	Electricity	Venezuela
	Aguaytía	Gas	Peru
	Amanco	Irrigation systems	Mexico
	Cemex-Construmex	Cement and home improvement products	Mexico
	Codensa	Electricity and appliances	Colombia
	Colcerámica	Tiles	Colombia
	Edenor	Electricity	Argentina
	Ejercito de Salvacion	Clothing and furniture	Argentina
	Empresario Azteca	Credit	Mexico
	Gas Natural Ban	Gas	Argentina
	INACAP	Education	Chile

remaining 11, LIS were targeted as an additional market segment that supplemented the core business. In both types of situations we sought to uncover the driving forces that led to undertaking the activity, such as pursuing new business opportunity, reacting to threats in the environment, or following up philanthropic endeavors.[50] For each activity we asked: how did the forces leading to the initiative shape the business models deployed and the outcomes attained? What particular factors appear to have influenced the capacity of the initiative to generate economic and social value?

Finally, it should be noted that most of the initiatives included in the sample case did not target the poorest among the region's poor—at least not as potential consumers. The initiatives studied tended to target the "middle of the road" among the poor: the populations served looked like the middle of the bell curve of the income pyramid. Figure 1.3 below illustrates this point with three rather different cases: the Aztec Entrepreneur program (Programa Empresario Azteca), an initiative that sought to finance and sell machinery to the poor in Mexico; the National Institute for Professional Training (Instituto Nacional de Capacitación Profesional, or INACAP); a non-profit organization which provides top quality professional training to disadvantaged youth in Chile at a profit; and Codensa, a Colombian public utility company that sought to increase customer loyalty through the financing and selling of electronic products.

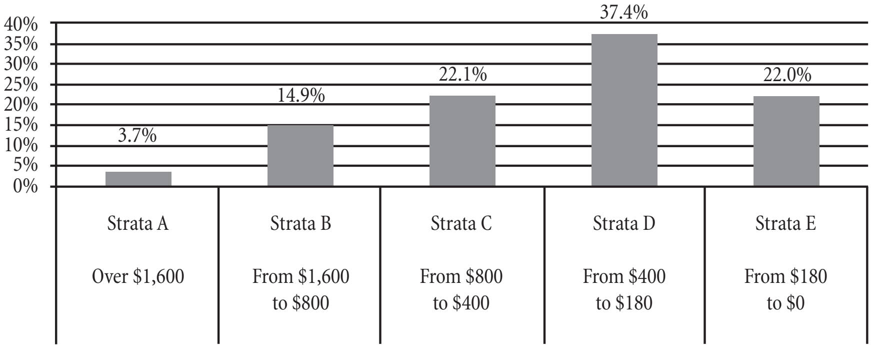
Figure 1.3
Segmenting the low-income sector consumers

1.3.a. ***Programa Empresario Azteca:*** **Selling tools to the poor in Mexico**



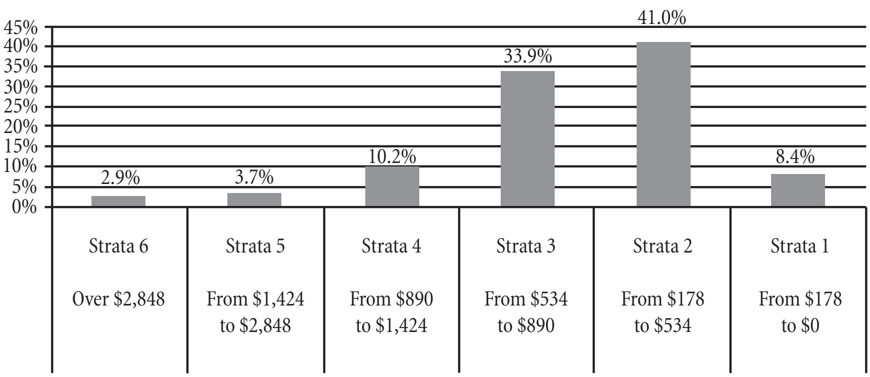
Socio-economic status of EA customers. Adapted by authors from data by EA and the Asociación Mexicana de Agencias de Investigación de Mercados y Opinión Pública (AMAI).

1.3.b. INACAP: Giving top-quality professional training to the poor in Chile, profitably



Socio-economic status of INACAP students, by 2006. Adapted by authors from data from the Sistema nacional de medición de resultados de aprendizaje (SIMCE), Chilean Ministry of Education.

1.3.c. Codensa: Democratizing credit in Colombia through a public utility company



Socio-economic status of Codensa customers, by 2006. Adapted by authors from company data.

The Poor as Producers and Suppliers

After the initial wave of BOP scholarship, which saw the poor primarily as an untapped consumer market, later formulations pointed out that significant progress in poverty reduction could not be achieved without increasing their income—improving their "balance of payments" vis-à-vis the rest of society, with more money flowing in and less coming out.[51] To raise income, it is necessary to "turn LIS into partners."[52] Thus, we examine not only how to "serve" the needs of the poor, but also how to work with them, in different capacities, in the construction of socially inclusive market initiatives.

In another 15 cases we analyzed, LIS participated as producers. This group falls into two categories (reflected on two columns in Table 1.3): self-organized partnerships to bring goods to market or to supply other organizations, and producers who joined an initiative led by a larger organization, participating in its value chain as suppliers. In the first category we have recyclers, wild fruit gatherers, sisal growers, seamstresses, and miners. In all cases we analyzed the challenges LIS groups faced in their quest to undertake initiatives in local and global markets.

Table 1.3
The poor as producers in case sample

LIS Organization	Country	Organization launching initiative	Country
APAEB	Brazil	Agropalma	Brazil
ASMARE	Brazil	Cativen	Venezuela
Centro Interregional de Artesanos del Peru (CIAP)	Peru	Costa Rica Entomological Supplies (CRES)	Costa Rica
Coopa-Roca	Brazil	Explorandes	Peru
Cooperativa de Recicladores Porvenir	Colombia	Hortifruti-Tierra Fertil	Central America
Coordinadora Regional de Recolectores y Recolectoras de las Región del Bio Bio	Chile	Irupana	Bolivia
Corporación Oro Verde	Colombia	Palmas del Espino	Peru
El Ceibo Recuperadores Urbanos	Argentina		

Organization of the Book

This book is organized in three modules. The first centers on actors: LIS groups participating in market initiatives, and organizations to which they are linked. A second part examines sectors where initiatives were developed, and the final section reviews the extent to which value creation was achieved.

Actors

Four chapters describe the actors involved in market-based initiatives with LIS as well as the collaborative arrangements among them. Chapter 2 focuses on the experience of thirteen large companies, critically assessing the comparative advantages held by large private firms in developing market initiatives with LIS as consumers and suppliers. A key query in this chapter is the centrality of LIS in the organization's purpose, a feature that appears to influence the venture's effectiveness.

Chapter 3 offers an in-depth look at LIS ventures led by SMEs. Issues discussed include how mission centrality focused on LIS markets, flexibility of management policy and practice, ongoing attention to opportunity for innovation and containment of operating costs, together with proximity to LIS, can lead to success in developing inclusive business ventures. These issues, considered crucial for inserting LIS in value chains, are examined against the backdrop of limitations that often plague SMEs and chip away profit margins. These may include diseconomies of scale, limited geographic reach, limited product portfolio, and (in emerging economies) access to external sources of financing.

Chapter 4 puts forward the concept of "social enterprise," a non-traditional category that encompasses both CSOs and cooperatives. This chapter seeks to uncover similarities among cooperatives and nonprofit organizations as they operate in socially inclusive market initiatives. Study of thirteen experiences yields insights into the potential for innovation through market mechanisms that feature the venture's beneficiaries in prominent roles. Also examined are the business models employed in building market initiatives with LIS, highlighting the role of creative leadership.

The final chapter in this module reviews the different organizational ecosystems where the various ventures were undertaken. Attention focuses on exploring the particular features of each, assessing those that appear to have been crucial in breaking down barriers that hindered fruitful value exchanges with the poor. A particular feature of socially inclusive ventures is that they are often built upon communities of interest, of different groups that interact in pursuit of a common goal. The chapter examines various types of players that perform a number of roles. The nature of their relationships can vary greatly: from semi-hierarchical to horizontal and cooperative linkages; and from loose, contract-based ties to structured joint-ventures.

Sectors

The guideline for our case selection was to shape a set that would be heterogeneous in terms of organizational form, industries, and geographical scope. Yet once the data gathering was completed, it became evident that three sectors stood out: agribusiness, recycling, and public utilities. This made sense: LIS have traditionally played a major role as producers and suppliers in the first two. The third one, however, exemplified an emerging field of concern in inclusive business, with the potential of having enormous impact on the living conditions of the poor. The initiatives encompassed in this last group reacted creatively to contextual challenges, and broadened their reach to include LIS in their respective value chains.

In chapter 6 five experiences in public utilities are examined: three in electric power supply, and two in natural gas. The electric services were delivered in large metropolitan areas in Argentina, Colombia, and Venezuela; the natural gas ventures took place in Argentina and Peru. Each experience provides the opportunity for discussing how tradition-bound companies crafted innovative business models to serve LIS consumers. One overcame a long-standing practice whereby poor consumers tapped power lines to obtain free electricity; another succeeded in halting pressures on state regulatory agencies to hold utility prices artificially low for political gain. These companies learned to develop attractive value propositions for poor consumers—by highlighting the tradeoff between delivering improved service to the poor and generating profit.

Chapter 7 focuses on LIS as recyclers. For decades, the Latin American urban poor made a living through the recycling of solid waste in metropolitan areas. The importance of this activity has recently increased, as the global economic crisis expelled individuals from the formal economy, and as the sustainability agenda created demand for recycled goods. The authors examine the experience of entrepreneurial organizations led by LIS groups, focusing on the leadership and innovation that enabled them to transform the recycling practices in their respective communities.

Chapter 8 examines the challenges firms face when they seek to bring rural communities, where insufficient infrastructure and poverty are a common denominator, into value chains linked to mass markets or high-end consumers. The discussion shows how the companies involved learned to overcome such challenges, weighing the benefits of long-term versus short-term gains.

Value Creation

Can profit be made by serving the poor? This overriding question remains an issue of current debate: Prahalad[53] holds there is a fortune to be made by eradicating poverty; whereas Karnani[54] and others deem this a mirage, for in their opinion business engagement with the poor, even in the best of circumstances, is costly and difficult. Both views may be right: our sample harbors both solid success stories and others that failed to fulfill their alleged "great potential."

The final section of this book examines economic and social value created by the array of initiatives included in the study. Building on previous SEKN work, new approaches deemed valid for gauging social impact on individual's lives, communities, and society as a whole are explored. To measure economic value in market initiatives with LIS, the authors take into account margins, earnings, and sustainability. Results attained by organizations where engagement with LIS lies at the core of the venture, are compared to those where the initiative is limited to a particular project. Similarly, results obtained by different kinds of organizations are assessed. Also examined are tensions emerging from efforts to create economic and social value in market-based initiatives with LIS.

How successful were these initiatives in creating material wealth for participants? Chapter 9 deals with this question and examines economic success in doing business with LIS. The analysis highlights the differences in economic value creation between organizations whose business engagement with LIS lies at the core of their mission, vis-à-vis social projects undertaken within, for example, the realm of corporate social responsibility. SEKN authors review a wide set of conditions that must be met in order to generate profits. These include cost controls, facilitating credit and payment terms for poor consumers, and developing appropriate yardsticks and indicators for measuring market success.

Chapter 10 deals with the other half of the value creation process. How was social value generated for LIS participating as consumers, suppliers, or partners in each of the ventures examined? In what ways did these initiatives favorably impact individuals, communities, or society as a whole? This chapter seeks to determine how the experiences analyzed lowered the market barriers hitherto encountered by LIS, thus opening access to goods and services, promoting human rights and dignity, and expanding individual and family income. The authors investigate whether significant differences emerged from one experience to another, depending on the kind of organization or sector, and bring up issues related to scalability and opportunity for experience replication.

The overall purpose of all the chapters in this book is to expand the ongoing debate on business at the socio-economic base-of-the-pyramid in Iberoamerica. Beyond generating knowledge, SEKN has sought to contribute to practice by dissecting specific challenges faced by the organizations in the sample and the paths taken to overcome them. This book is an invitation to imagine new possibilities in business for greater economic prosperity and positive social transformation. With that in mind, we offer lessons on how market initiatives engaging the poor can be a powerful force to foster more equal and fair societies in the region.

Notes

1. James E. Austin and Michael Chu, "Business and Low-Income Sectors: Finding a New Weapon to Attack Poverty," *ReVista Harvard Review of Latin America* (2006): 3.
2. C. K. Prahalad, *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits* (Upper Saddle River, NJ: Wharton School Publishing, 2005), 11; Allen L. Hammond et al., *The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid* (Washington, DC: World Resources Institute and International Finance Corporation, 2007).
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4. Henry Chesbrough, "Business Model Innovation: It's Not Just about Technology Anymore," *Strategy & Leadership* 35, no. 6 (2007): 13.
5. Ted London, "The Base-of-the-Pyramid Perspective: A New Approach to Poverty Alleviation" (Working Paper, William Davidson Institute/Stephen M. Ross School of Business, 2008), 12.
6. Latin American countries use different criteria to classify companies as SME or large. In deciding how to classify each case, this study followed the criteria prevailing in the company's country of origin. These criteria vary significantly from nation to nation. For instance, in Argentina the criteria used is annual sales, but this differs among manufacture, commerce and service. In Chile there are two criteria: employment and sales. In Colombia SME status is determined by number of employees and total assets (wwww.fundes.org).
7. SEKN, ed. *Effective Management of Social Enterprises Lessons from Businesses and Civil Society Organizations in Iberoamerica* (Cambridge, MA: Harvard University Press with David Rockefeller Center for Latin American Studies, 2006), 226.
8. C. K. Prahalad and Stuart Hart, "The Fortune at the Bottom of the Pyramid," *Strategy + Business* 1, no. 26 (2002); C. K. Prahalad and Allen Hammond, "Serving the World's Poor, Profitably," *Harvard Business Review* (2002).
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10. James Austin et al., "Building New Business Value Chains with Low Income Sectors in Latin America," in *Business Solutions for the Global Poor: Creating Social and Economic Value*, ed. Kasturi Rangan, et al. (San Francisco, CA: Jossey-Bass, 2007).
11. Ted London, "The Base-of-the-Pyramid Perspective: A New Approach to Poverty Alleviation" (Working Paper, William Davidson Institute/Stephen M. Ross School of Business, 2008); Jacqueline Novogratz, "Meeting Urgent Needs

with Patient Capital," *Innovations: Technology | Governance | Globalization* 2, no. 1/2 (2007).

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13. Ted London, "The Base-of-the-Pyramid Perspective: A New Approach to Poverty Alleviation" (Working Paper, William Davidson Institute/Stephen M. Ross School of Business, 2008), 24.
14. C. K. Prahalad and Stuart Hart, "The Fortune at the Bottom of the Pyramid," *Strategy + Business* 1, no. 26 (2002).
15. George C. Lodge, "The Corporate Key: Using Big Business to Fight Global Poverty," *Foreign Affairs* 81, no. 4 (2002).
16. Aneel Karnani points out that many of the cases used by Prahalad in "Fortune at the Bottom of the Pyramid" are not MNCs: Casas Bahía is a large Brazilian Company; Voxiva is an SME, and Aravind is a CSO. Aneel G. Karnani, "Fortune at the Bottom of the Pyramid: A Mirage" (Working Paper No. 1035, University of Michigan, Stephen M. Ross School of Business, 2006).
17. "While a number of authors have highlighted the important role that non-native multinational corporations (MNCs) can play in serving the base of the pyramid . . . BOP ventures are not the sole purview of these large companies. In fact, a variety of different external organizations and individuals can launch BOP ventures. As discussed in the BOP literature, these ventures also emerge from the host-country private sector as well as nonprofit organizations and other socially-oriented enterprises." Ted London, "The Base-of-the-Pyramid Perspective: A New Approach to Poverty Alleviation" (Working Paper, William Davidson Institute/Stephen M. Ross School of Business, 2008), 14. See also, David Wheeler et al., "Creating Sustainable Local Enterprise Networks," *MIT Sloan Review* 47, no. 1 (2005).
18. Allen L. Hammond et al., *The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid* (Washington, DC: World Resources Institute and International Finance Corporation, 2007).
19. *Stichting Nederlandse Vrijwilligers*, the Netherlands' Development Organization.
20. Ted London, "The Base-of-the-Pyramid Perspective: A New Approach to Poverty Alleviation" (Working Paper, William Davidson Institute/Stephen M. Ross School of Business, 2008), 14.
21. "The aspiring poor present a prodigious opportunity for the world's wealthiest companies. But it requires a radical new approach to business strategy." C. K. Prahalad and Stuart Hart, "The Fortune at the Bottom of the Pyramid," *Strategy + Business* 1, no. 26 (2002). In this view, radical innovation should not be restricted to products, but encompass also processes. C. K. Prahalad, *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits* (Upper Saddle River, NJ: Wharton School Publishing, 2005).

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26. Christian Seelos and Johanna Mair, "Profitable Business Models and Market Creation in the Context of Deep Poverty: A Strategic View," *The Academy of Management Perspectives* 21, no. 4 (2007): 61.
27. C. K. Prahalad and Stuart Hart, "The Fortune at the Bottom of the Pyramid," *Strategy + Business* 1, no. 26 (2002); C. K. Prahalad, *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits* (Upper Saddle River, NJ: Wharton School Publishing, 2005).
28. Ted London and Stuart L Hart, "Reinventing Strategies for Emerging Markets: Beyond the Transnational Model," *Journal of International Business Studies* 35 (2004): 362.
29. Ted London, "The Base-of-the-Pyramid Perspective: A New Approach to Poverty Alleviation" (Working Paper, William Davidson Institute/Stephen M. Ross School of Business, 2008), 22.
30. C. K. Prahalad, *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits* (Upper Saddle River, NJ: Wharton School Publishing, 2005), 4.
31. Allen L. Hammond et al., *The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid* (Washington, DC: World Resources Institute and International Finance Corporation, 2007), 3.
32. CEPAL, "Panorama social de América Latina 2007." (Comisión Económica para América Latina y el Caribe, 2007), http://www.eclac.org/publicaciones/xml/5/30305/PSE2007_Cap1_Pobreza.pdf.
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34. Comisión Económica para América Latina, "Anuario estadístico de América Latina y el Caribe." Naciones Unidas, División de Estadísticas y Proyecciones Económicas. Santiago: 2007.
35. Ibid.
36. Michael Förster and Marco Mira d'Ercole, "Income Distribution and Poverty in OECD Countries in the Second Half of the 1990s" (OECD Social, Employment and Migration Working Papers. Paris: 2005).
37. "La pobresa a Catalunya. Informe 2003," Fundació UN SOL MÓN de l'Obra Social de Caixa Catalunya, http://obrasocial.caixacatalunya.es/CDA/ObraSocial

/OS_Plantilla3/0,3417,1x3y355,00.html. The autonomic parliament approved the creation of social enterprises for labor inclusion (*empresas de inserción*) to develop market activities for the integration of people under great risk of social exclusion.

38. "Panorama social 2007 de América Latina," Comisión Económica para América Latina y el Caribe, http://www.eclac.org/publicaciones/xml/5/30305/PSE2007_Sintesis_Lanzamiento.pdf.
39. The Gini coefficient is the indicator utilized to measure inequality of income distribution, where 0 corresponds to perfect equality of income, and 1 to perfect inequality (with one person capturing 100% of available income, and everyone else 0%).
40. "Indicadores de concentración del ingreso, total nacional, 1990–2006 (cuadro 14)," Comisión Económica para América Latina y el Caribe, http://www.eclac.org/publicaciones/xml/5/30305/PSE2007_AnexoEstadistico.xls.
41. World Economic Forum, "Latin America@Risk. A Global Risk Network Briefing," www.weforum.org/pdf/grn/LatinAmericaRisk.pdf.
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44. Self-funding by entrepreneurs and funding from informal investors constitute the lifeblood of an entrepreneurial society. Aside from providing 65.8 percent of the start-up capital for their own companies they are four times as likely as non-entrepreneurs to be informal investors in another entrepreneur's business. Informal investors supply more than the external capital needs of entrepreneurs. Zoltan J. Acs et al., "Global Entrepreneurship Monitor. 2004 Executive Report" (Babson Park, MA: Babson College, 2005).
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46. Gabrielle Quinti, "Exclusión social: el debate teórico y los modelos de medición y evaluación," in *De Igual a Igual: El desafío del Estado ante los nuevos problemas sociales*, ed. Jorge Carpio and Irene Novacovsky (Buenos Aires: Fondo de Cultura Económica de Argentina y Secretaría de Desarrollo Social de la Nación, 1999), 289–304.
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48. C. K. Prahalad, *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits* (Upper Saddle River, NJ: Wharton School Publishing, 2005), 1.
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50. James Austin et al., "Building New Business Value Chains with Low Income Sectors in Latin America," in *Business Solutions for the Global Poor: Creating Social and Economic Value*, ed. Kasturi Rangan et al. (San Francisco, CA: Jossey-Bass, 2007).
51. "Increasing income generated in the low-income community requires interventions or changes that alter one or more of these balances—that increase consumption that is locally-produced, that increase investment activities using local materials, that provide government services using inputs from the local community, or that expand exports." Herman B. Leonard, "When Is Doing Business with the Poor Good—for the Poor? A Household and National Income Accounting Approach," in *Business Solutions for the Global Poor: Creating Social and Economic Value*, ed. Kasturi Rangan et al. (San Francisco, CA: Jossey-Bass, 2007).
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