GAINING SHAREHOLDER VALUE FROM THE BOTTOM OF THE PYRAMID

Rana Mustansir
Pakistan Institute of Corporate Governance

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Key words: Corporate Social Responsibility, shareholder value, Bottom of the Pyramid

Abstract

Company management believes shareholders are wary of social responsibility agendas because they see them as eroding the competitiveness of business by adding to its costs. Shareholders are reluctant to allow their companies to be associated with social responsibility because it is not the business for which they provide funds to management.

C.K. Prahalad's (2004) Bottom of the Pyramid theory sought to capture shareholders' imagination by identifying a potential market of trillions of dollars of disposable income for multinational corporations by selling to the poorest of the poor in the developing world.

Though this theory has been criticized for its lack of ethical concerns, and although Prahalad himself clearly disassociated it from corporate social responsibility, there is a case for businesses to profit from a social cause. If making a profit by selling to the lowest income groups can transform them in to discerning consumers with the power to make buying decisions, then business could be a catalyst for social justice.

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Introduction

In *Fortune at the Bottom of the Pyramid*, Prahlad (2004) declared that the subject matter of his book were the more than 4 billion people who live at the BOP on less than $2 per day. Taken seriously as a market, BOP could afford the private sector a further opportunity for growth and innovation. BOP markets must become an integral part of the work of the private sector. They must become part of the firms' core businesses; they cannot merely be relegated to the realm of corporate social responsibility (CSR) initiatives.
This paper attempts to converge CSR and BOP from the perspective of the business and the customer as opposed to that of the philanthropist and the poor.

Section 1 presents a brief literature review that touches upon different conceptualizations of corporate social responsibility and what constitutes the bottom of the pyramid.

Section 2 traces the origins of the theory of shareholder value and why shareholders are assumed to resist a corporation's social responsibility initiatives.

Section 3 weighs the stakeholder approach to CSR in the context of changing business models needed to cater to the needs and wants of the bottom of the pyramid consumer.

Section 4 presents concluding thoughts on shareholder value at the bottom of the pyramid and how business should change with the changing dynamics of this particular market.

Conceptualization of corporate social responsibility and Bottom of the Pyramid models

Carroll (1979) defined corporate social performance as a multidimensional construct having four components: economic responsibility to investors and consumers; legal responsibility to the government; ethical responsibility to society; and discretionary or philanthropic responsibility to community. Carroll depicts the four types as a pyramid with economic responsibilities or profitability as the base (Figure 1).

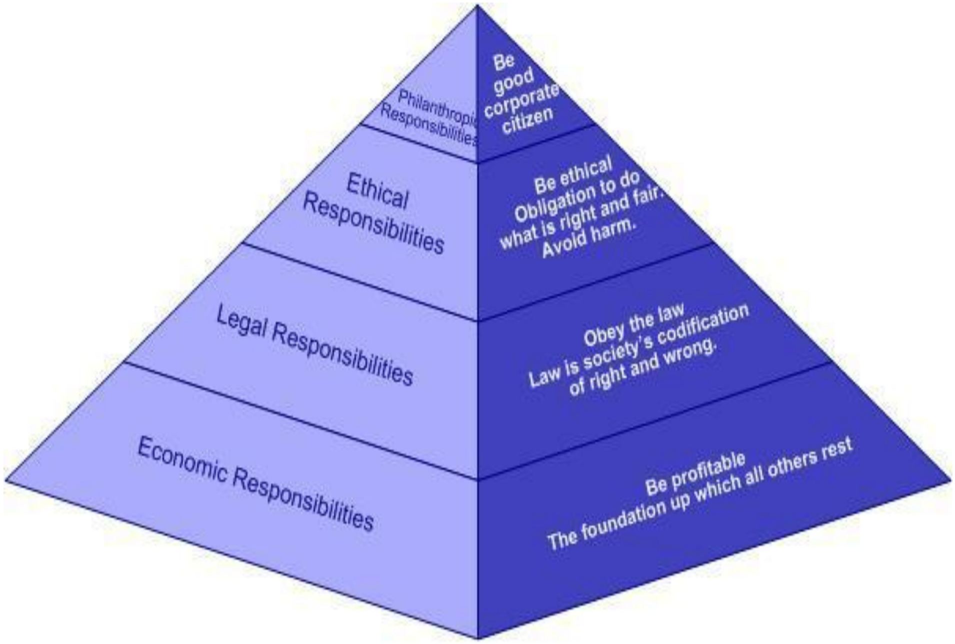

Figure 1. Carroll's Corporate Social Performance Pyramid

Prahalad and Hammond argued that:
By stimulating commerce and development at the bottom of the economic pyramid, MNCs could radically improve the lives of billions of people and help bring into being a more stable, less dangerous world.
Serving the World's Poor, Profitably, Harvard Business Review September 2002

Prahalad advocated the use of new business models to target low income markets, such as rethinking the approach to pricing. According to him, traditional pricing sums the costs of a production and distribution system and then adds on a profit margin, whereas selling to low income consumers requires determining what these consumers are able to pay, deducting a profit margin, and then working out how to deliver the product within that budget. Prahalad emphasized that these markets needed to be built, not simply entered in to. Critics of the BOP, such as Jenkins (2005), censured Prahalad for consistently overestimating the potential purchasing power of poor people.

Why BOP disassociated itself from CSR

Prahalad (2004) rejected corporate social responsibility as the basis for BOP initiatives. At its core, corporate social responsibility was conceived not as a means to eradicate poverty, but to compel business to operate in a manner that meets or exceeds the ethical, social, legal, and commercial expectations that society has of it.

Although poverty reduction has not been an explicit element of CSR, that does not preclude the adoption of socially responsible business practices that have an impact on poverty reduction in developing countries (Jenkins, 2005).

Aneel Karnani, Assistant Professor of Strategy at the University of Michigan's Stephen M Ross School of Business is a fierce opponent of the idea that companies have a responsibility to act in the public interest and that they will profit from doing so. He argues that the size of the low-end market is too small for firms to exploit profitably and sustainably (Karnani, 2007). [1]
According to the professor, services and products targeting consumers at the “bottom of the pyramid,” wrongly portray poor people as discerning consumers (*Romanticizing the Poor*, Stanford Social Innovation Review 2009). The real life example of a rickshaw puller on the streets of Dhaka, who would rather buy tobacco for himself than buy eggs for his children, is used to demonstrate the poor judgment of a deprived man (Efroymson& Ahmed, 2001).

Professor Karnani contends that poor people face different socio-economic realities compared to rich people, and just being poor hinders their ability to make wise decisions. He

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[1] Karnani summarizes the BOP proposition as follows:
As there is much untapped purchasing power at the bottom of the pyramid, private companies can make significant profits by selling to the poor.
By selling to the poor, private companies can bring prosperity to the poor by selling to them, and thus help eradicate poverty.
Large multinational companies (MNCs) should play a leading role in this process of selling to the poor.

Karnani, A. (2007) *The Mirage of Marketing to the Bottom of the Pyramid: How the Private Sector Can Help Alleviate Poverty*, California Management Review, 49(4), 90-111 also questions microcredit's capacity to significantly alleviate poverty and instead romanticizing 'poor people as creative entrepreneurs' (Karnani, 2007). Prahalad himself admitted that 'profit creation and poverty alleviation do not mix easily or well'.

Are shareholders really against CSR

According to Doyle and Stern (2006) there are two extreme views on CSR. One view is that CSR distracts management from focusing entirely on its strategic business objective of increasing shareholder value. The opposing view is that since corporations often extract scarce resources from the environment, they must be willing to safeguard it and so give back to community and society.

Barnea and Rubin (2010) argue that a firm's insiders, that is, managers and large blockholders, may seek to overinvest in CSR because doing so accrues a private benefit in the form of enhanced reputations as good global citizens. The results of their study support its hypothesis that insiders induce firms to overinvest in CSR while they bear little of the cost of doing so.

In a Working Paper titled *The Influence of Shareholders on Corporate Social Responsibility*, Katherine Glac (2010) says that despite their projection as 'narrow-minded profit maximizers', who refute management's vision for a socially responsible business, shareholders have become one of the most important allies of the corporate social responsibility movement. According to Glac, the CSR movement has been enriched on the one hand by shareholder activism that has supported the creation of firms which allow individuals to channelize concerns about the responsible conduct of business thereby initiating a shift in legislation, and on the other hand by a more passive form of shareholder engagement known as socially responsible investing (SRI).

Shareholders have also been sensitized to environmental CSR. Shareholder perceptions have changed toward announcement of eco-harmful corporate behavior and eco-friendly corporate initiatives making it worthwhile for managers and boards to design and implement effective environmental CSR policies (Flammer, 2012).

Godfrey et al. (2009) show that negative stock market reaction to the announcement of legal action against companies, such as patent infringements or quality control issues, is significantly mitigated for firms that participate in institutional CSR activities.

According to an Ernst & Young report, big companies' corporate social responsibility efforts are increasingly being driven by their shareholders as more investors grasp how corporations' environmental and social efforts can impact their bottom line (*Climate Change and Sustainability: Shareholders Press Boards on Social and Environmental Risks*, Ernst & Young 2011).

How is shareholder value created and destroyed

The theory of shareholder value gained traction in the 1970s when big corporations lost focus on performance. Way back in 1993, when Lou Gerstner announced that 'shareholder value' would become one of IBM's core principles, it sounded like a good plan to get floundering businesses back on track.

In an interview with the Financial Times in 2009, Jack Welch, legendary former CEO of GE and outspoken advocate of the shareholder movement, described shareholder value as the 'dumbest idea in the world'. What Mr. Welch meant, as he later explained, was that shareholder value as a strategy is a dumb idea because shareholder value is an outcome of the implementation of successful strategies, not a strategy in itself (*Welch Denounces Corporate Obsessions*, Financial Times March 2009).

It follows, thus, that an outwardly focus on shareholder value may stand to destroy the internal controls of a company as well as its external credibility.

The UK Companies Act 2006 introduced the concept of 'enlightened shareholder value'[2] which requires companies to think about corporate social responsibility factors in the long run. The law makes it obligatory on directors to take in to account factors other than what is in the best interests of shareholders while making business decisions. So, for example, if directors endorse a decision to outsource manufacturing to a factory with no safety standards for its workers, they must be ready to answer to shareholders whether the short term financial gains from that decision were justified when it comes to bear on the company's share price in the long run.

There is not much empirical evidence to demonstrate the convergence between shareholder value maximization and the social function of the company. Research on identifying whether adoption of CSR practices has an impact on a firm's operations, valuations, and customer perceptions has borne mixed results. Lopez et al. (2007) observe negative, short-term impacts on the performance of firms that adopt socially responsible practices. However, Lo and Sheu (2007) studied a subsample of S&P 500 firms from 1999 to 2002 and found that these firms fared better after incorporating responsible business strategies into their business plans.

Needs versus wants at the Bottom of the Pyramid: A stakeholder approach to CSR

It is often said that a company is responsible to its stakeholders, that is, those affected by the company's actions such as employees, customers, suppliers or the local community. Corporate social responsibility is defined as the company's responsibility to meet its obligations to its stakeholders, not the needs of those stakeholders. Senior management and

[2] The UK Companies Act 2006 modified the principle of traditional shareholder value. Enlightened shareholder value (ESV) is the idea that corporations should pursue shareholder wealth with a long run orientation that seeks sustainable growth and profits based on responsible business conduct that takes in to consideration the full range of relevant stakeholder interests. Included in this provision is a requirement for directors to have regard for the interests of certain stakeholders when exercising their duty to promote the success of their company.
Section 172(1) UK Companies Act, 2006

marketers often struggle with the concept of CSR as it holds business accountable to society at large (Maignan et al., 2005).

A paper by Freeman and Velamuri (2005) provides a brief history of the development of the stakeholder approach to business. The stakeholder approach emerged in the mid-1980s in response to the concerns of not only shareholders, but employees, customers, suppliers, lenders and society. This approach sought to broaden the concept of business beyond its traditional economic roots, by defining stakeholders as 'any group or individual who is affected by or can affect the achievement of an organization's objectives'.

For Freeman and Velamuri, CSR stands for Company Stakeholder Responsibility. The authors present ten general principles[3] that make up a *mindset* that is necessary to comprehend Company Stakeholder Responsibility.
Of these ten, the two that really stand out are:

i) constant monitoring and redesigning of processes to better serve stakeholders; and

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[3] Freeman and Velamuri present ten general principles that make up a 'mindset' necessary to understand and practice all four levels of Company Stakeholder Responsibility:
1. Managing stakeholder interests based on the idea that the process of value creation is a joint process.
2. Believing that stakeholders are real people
3. Seeking solutions to satisfy multiple stakeholders simultaneously.
4. Communicating intensively and having regular dialogue with stakeholders-
5. Managing stakeholder relationships internally, rather than leaving it to government.
6. Using marketing techniques and market research tools to categorize, and understand the nature of, stakeholder groups.
7. Never trading off the interests of one stakeholder group versus the other.
8. Negotiating with primary and secondary stakeholders
9. Constantly monitoring and redesigning processes to serve stakeholders
10. Aspiring to fulfill commitments to stakeholders.

Freeman, R.E. and Velamuri, S.R. (2005) *A New Approach to CSR: Company Stakeholder Responsibility*
Available from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1186223

ii) a marketing approach that understands stakeholders' needs using marketing techniques to categorize stakeholder groups in order to gain a better understanding of their needs.

Changing Business Models for the BOP

Boyle and Boguslaw (2007) have suggested that the 'stakeholder theory' fails to take the lowest income groups in to account when making business decisions since they are not considered to have a stake in the business.

By changing its business model, a company can adapt to certain purchase triggers peculiar to this consumer segment. This approach opens up markets where price, distribution challenges, or other barriers have made entry difficult. Since most large businesses have not designed their product development, marketing and supply chain functions to serve lower income consumers, they could benefit from:

i) designing, distributing and presenting products and services in a format that meets the unique requirements of each customer demographic;

ii) employing appropriate distribution and media channels to effectively connect with the target market; and

iii) maximizing the overall value proposition of products instead of solely concentrating on developing a low cost product for these consumers.

Marketing to the low income consumer

Ibok (2011) observes that the marketing attention given to low income consumers in organizational plans is minimal if not completely neglected, and that there has been no systematic examination in marketing literature of the implications of marketing and selling to these consumers.

Prahalad (2004) observed that this consumer segment is often exploited by selling to it low cost, substandard products. However, the combined purchasing power within this market warrants marketers' interest. According to Akan and Esua (2007) any marketing management that can successfully conceptualize the operational variables of the low income consumer group will be poised for market leadership.

Despite its market potential, this consumer segment has remained untapped, or underserved, since there is minimal understanding of its needs (Odon, 2008). There seems to be little understanding of the unique characteristics of this market (Adkins and Ozanne, 2005; Soyibo, 2007).

An often cited example of marketing to the bottom of the pyramid gone wrong is Procter & Gamble's PUR, a chemical treatment developed in partnership with the US Center for Disease Control and Prevention that converted contaminated water into pure drinking water.

One sachet of PUR could purify almost three gallons of water and retailed for just 10 cents. Three years of test marketing in four countries returned mostly low penetration rates as well as a weak return on investment. PUR was a huge commercial failure, but P&G turned it in to a philanthropic success by donating or providing at cost hundreds of millions of PUR packets to relief efforts and nonprofit organizations through the company's Children's Safe Drinking Water initiative.

Engro Corp. is a Pakistani conglomerate with a portfolio of seven businesses including chemical fertilizers, PVC resin, a bulk liquid chemical terminal, industrial automation, foods, power generation and commodity trade.

In 2011 Engro Corp. achieved 22 percent volume growth through diversification in to the low cost, good quality product category with the launch of Dairy Omung for lower income consumers. Earlier, Engro had successfully launched its tea creamer Tarang to this segment (Annual Report, 2011).

The company clearly understands its consumer segment's characteristics. First, that price is a major determining factor in product patronage. Second, limited income consumers also tend to be brand selective. Most important, advertising to this segment should be done through traditional media and the use of vernacular. Tarang television advertisements feature an elaborate song and dance routine popularized by the cultural influence of cinema that appeals so much to Pakistani masses (Figure 2).

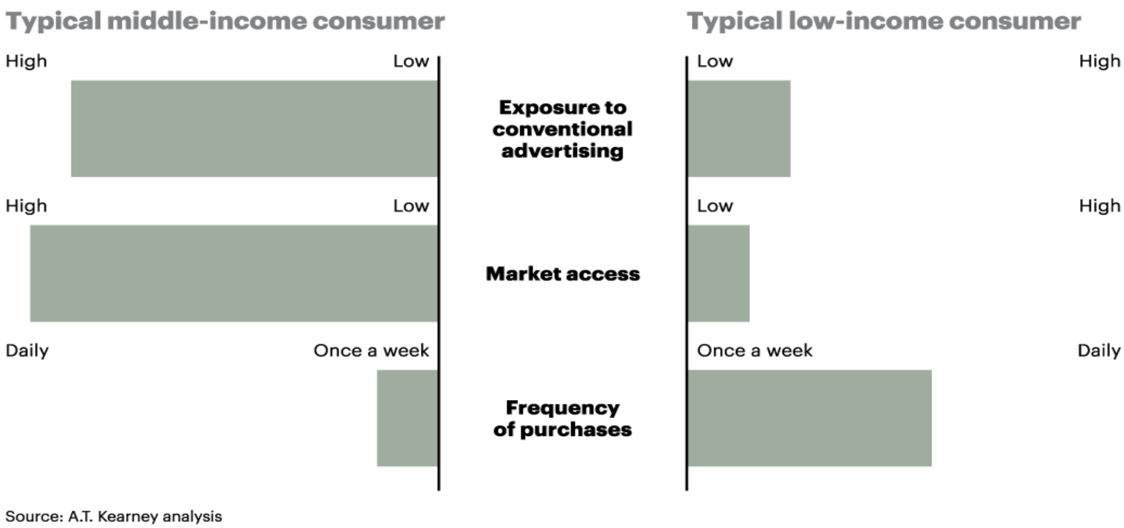

Figure 2. The gap between middle income and low income consumers for product awareness

Cornell University's Erik Simanis offers a reality check at the bottom of the pyramid. To cover the higher costs of operating in low-income markets, Simanis says companies need a three pronged approach: localized base products sold as a bundle, an enabling service, and customer peer groups.To sustain high margins, a service provider must develop a close relationship with its customers and provide them with the knowledge and skills needed to maximize the products' functionality (*Reality Check at the Bottom of the Pyramid*, Harvard Business Review June 2012).

Pakistan's second largest mobile operator Telenor, of Norwegian Telenor Group, gives low income customers the option to purchase an affordable internet-enabled handset with internet usage for free. The handsets that have been made available at Telenor Pakistan touch points include Q-Mobile Bolt A2 lite, Q-Mobile Bolt A4, Nokia Asha 205 and Nokia Asha 301 priced at Rs 6,500, Rs 8,250, Rs 5,900 and Rs 9,350 respectively. The company says it aims to bring new and innovative offerings to enable customers to conveniently and cheaply access telecommunication services across the country.

In collaboration with the nonprofit Aga Khan Rural Support Program, Telenor has created the Agricultural Commodity Tool (ACT) for small farmers to get current prices of agricultural products from across the country as a short message service (SMS) on their mobile phone devices.

Is there shareholder value at the Bottom of the Pyramid?

Research by Hillman and Keim (2001) shows that investing in stakeholder management may complement shareholder value creation as a firm creates important resources and capabilities that differentiate it from its competitors. On the other hand, participation in social issues may at best turn out to be a transactional investment easily imitable by competitors.

A nimble company can learn from the bottom of the pyramid and change product design to achieve a lower cost structure through reverse innovation and product localization. Nothing destroys shareholder value more than a lack of innovation. Even a giant like Apple managed to destroy shareholder value by its failure to quickly innovate, and by shifting its strategy from growth to hoarding cash.

The key to keeping a business going in the BOP market segment, according to Martinez and Carbonell (2007), is through solid business performance; a business that consistently commits funds and resources to support profitable business segments that synchronize with the long term vision of the company and become an important source of income for the core business thereby creating value for the shareholder.

Those at the higher rungs of society, including some in academia, are guilty of a kind of social justice elitism. Social justice elitists are known for their inability to self-reflect. We want to fight for what we believe in no matter what the resistance. If we believe the poor will always be poor, we will fight for it.

To win our fight, we must let the poor have bread because bread is good for them when what they really want is cake. According to that logic, a low income consumer must invariably choose to buy a sachet of water purifying chemical when what they really want to buy is a sachet of shampoo.

According to the World Bank's 2013 Bangladesh Poverty Assessment, the number of poor people in Bangladesh has steadily declined by 26 percent between 2000 and 2010 due to growth in labor income and changes in demographics. The number of poor people declined from nearly 63 million in 2000 to 55 million in 2005, and to 47 million in 2010. Fertility rates have been steadily dropping over the last several decades resulting in lower dependency ratios. Poverty declined 1.8 percent annually between 2000 and 2005, and 1.7 percent annually between 2005 and 2010. With an expanding labor force, the report encourages focus on creating 'female-friendly' work environments and labor policies that facilitate a higher level of female participation in the labor force. With more disposable income in their hands, these women would also become BOP customers.

The theory of Development Economics proposes sustained economic growth over time that improves the standard of living for the masses living in poverty in developing countries. One of the main goals of Development Economics is the formulation of public policies designed to bring about rapid economic growth.

Shahid Javed Burki, senior economist and former World Bank VP, suggests that for developing countries like Pakistan, economic growth can come from creating growth in retail trade by catering to the consumption needs of the rapidly growing lower middle class. That, he says, would add growth in agriculture, small and medium enterprises, and domestic trade. This is in line with Robert Malthus's (1836) theory of 'balanced growth' which stated that the two sectors of the economy— industry and agriculture — were markets for each other. One could not expand without expansion of the other.

In his work with the National University of Singapore's Institute of South Asian Studies, Mr. Burki says that for all of South Asia, and for Pakistan in particular, the increase in the steady flow of remittances has impacted on the size of this burgeoning class by drawing them out of poverty. Thus, meeting the demands of this new class of consumers could set in motion new dynamics that could change the structure of the country's rural and small town economies.

If the bottom of the pyramid is a viable consumer segment, then it deserves to be presented with the same choices that are available to top of the pyramid consumers.

Conclusion

C.K. Prahalad declared that the strength of companies' innovative approaches lies in their ability to offer choices to the poor. If, as an ancillary to that offer, businesses also instill in their bottom of pyramid consumers a sense of self-worth, they create dividends for their shareholders and fulfill a social responsibility.

The bottom of the pyramid theory has been criticized on the assumption that shareholders are reluctant to allow their companies to be associated with social responsibility because it appears altruistic, not strategic. But corporate responsibility is moving beyond mere philanthropy toward stakeholder engagement which includes engagement with customers.

Management guru Peter Drucker (1973) was of the view that since the purpose of a business is to create a customer, the business has only two basic functions: marketing and innovation. Even Karnani (2007) concedes that firms can profit from marketing to the poor through significant price reduction by innovatively changing the price-quality trade-off.

C.K. Prahalad wanted BOP markets to become an integral part of firms' core businesses, not relegated to corporate social responsibility initiatives. His legacy will live on as the BOP market gets bigger, richer, and more profitable for large businesses provided they bring the right mix of quality and affordability to these consumers not as a matter of social responsibility, but for the sake of responsible business conduct.

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