

Times MBA Podcasts Week 6 – CK Prahalad: Democratising Commerce: The Challenge for the 21st Century

This is CK Prahalad, the Paul and Ruth McCracken Distinguished University Professor at the University of Michigan, Ross School of Business. I am going to be talking today about democratising commerce, the challenge for the 21st century, which also happens to be one of the most interesting strategic opportunities available to the organised sector, be they local or global.

I am very excited to share with all of you today an emerging opportunity that is big, that is exciting and that has been latent for a long time. What I am going to talk about is how to democratise commerce, which I believe is the challenge for the 21st century. If you think about it carefully, 80 per cent of humanity, or five billion people, have been below the radar screen of organised business, especially large businesses, be they domestic or be they global companies. At the same time, with democratising of various countries, a lot of people want to join and get the benefits of globalisation. They want to be both global consumers and producers. They are certainly micro-consumers because they are not rich. That is the reason why they have been excluded from the opportunities of being a good consumer.

At the same time they have also been excluded from participating in the global market place because they are micro-producers. They produce in very small quantities but in highly distributed areas, mostly in villages and in difficult to access markets. Therefore I think the next generation of opportunity is how to mobilise business for this majority. How to create inclusive capitalism that is both fair and socially equitable and at the same time profitable. This is the new challenge.

If you really look at what the debate has been it is whether globalisation is good or bad for the poor. I think the real debate ought to be how to make globalisation work for the benefit of all. And I start with a very simple premise, that if you look at the persistence of poverty, continuing ecological damage, disempowerment of the poor and ethnic conflicts and wars, they all seem to go together and they are the heart of all these issues of the five billion under-served or un-served people, especially un-served in the organised sector.

Therefore we need fundamentally new innovation and entrepreneurial initiatives, not the same old tired and very old recipes of subsidies and aid, but making them responsible for their own success and making it easy for them to succeed.

If you look at what has happened in the last 50 years, poverty alleviation or how to deal with the problems of the under-served has become a contested ideological market with public sector aid agencies and multilaterals trying to seek universal solutions to five billion poor, civil society organisations focused on social justice and not necessarily economic empowerment or economic growth, and philanthropy focusing on personal agendas. The one institutional player who has been absent from this is the private sector, the large firms including multi-national companies. My

starting assumption is poverty alleviation should become a problem that we solve, not become a constituency of any single group. In order to do that we have to start with a very simple premise.

The premise that I want to start with is every person has the right to have access to the benefits of the global economy. That must be the starting premise. That means we have to treat every person as a consumer and make available to that person world-class products and services at affordable prices. And more importantly, allow them to shape their own experiences. Not impose solutions from Washington or London, but allow them to shape their own experiences.

Second, each person should be treated fairly as a producer and have access to global markets and be paid fair wages. Now, this may look very utopian but this is where we have to start. If we start with these two premises, democratising commerce necessarily has to include five billion under-served in the market economy, both as micro-consumers and micro-producers. And that has been the substance of my book called *The Fortune at the Bottom of the Pyramid*. Sometimes people think that it is all about consumption and creating micro-consumers, but a significant part of my thesis has been how to make people micro-producers, gaining access to regional and global markets, even though they do not leave the villages in which they live.

At the same time people also have to shape their own experiences. That means the firm cannot be the dominant player any longer, the consumers have to have an equal say in what happens to their experiences and how they want to consume. That has been the substance of also the book that I co-authored called *The Future of Competition*. So, the bottom of the pyramid is the market and the co-creation of value and personalised experiences are two aspects of the same process of creating a democratic commerce.

So we have to start by at least asking ourselves how do we focus on mother industries for poverty alleviation? How do we focus on consumption, production and governance at the same time? How do we focus on innovation, entrepreneurship, and what are the socio-economic questions that this approach to poverty alleviation throws up and how do we deal with those?

I believe that there are five fundamental mother industries or key industries which are critical for poverty alleviation and I would put utmost connectivity, especially connectivity of information and therefore elimination of asymmetry of information as an approach to reducing poverty. If you look at the core issue in poverty it is all information arbitrage through middlemen, so if you want to eliminate poverty you have to eliminate the opportunities for information arbitrage. And that is the reason the wireless market is growing so rapidly in every poor country around the world, whether it is in sub-Saharan Africa, whether it is in Latin America, India or China. India alone is adding six million new consumers per month. This means that very soon between China and India alone we would have very close to 500 million cell users which is fundamentally a new market, and this has created a tremendous opportunity for companies. Just the four carriers of cell phone services in India have created a market capitalisation of \$75 billion plus in the last five years. So there is a huge opportunity to create economic value for the companies and at the same time getting people to be connected. This connectivity has changed the lives of ordinary people, from taxi drivers to small corner shops, road-side shops, to people who are plumbers and carpenters. All of their business models have changed. Now they can use the cell phone to increase their yields, increase their productivity. So the first

mother industry that is likely to create other industries and change business models in other industries is connectivity.

The second is the access to micro-finance. It was invented and sponsored by civil society organisations but the private sector has been quite active and increasingly large banks like ICICI have been at the forefront of creating micro-finance, not just access to credit but access to micro-insurance, access to other insurance, crop insurance, life insurance so this can provide not only P&L but balance sheet protection for the poor and is a very critical part for them to become more productive, reduce the poverty and certainly become consumers.

The three other industries where not much progress has been done, even though some early stage revival of these industries is obvious, is in health care, in the use of energy and certainly education. So connectivity has been totally created by private sector initiatives, certainly with the help of a government to release the spectrum and get out of the way but the entire revolution in cell phones so that three billion people may be connected for the first time in human history in the next three or four years has been done by the private sector. The revolution in micro-finance is equally stellar, including the remittance market and that has also been supported by civil society organisations and increasingly by the private sector. So the open question is whether health care, energy and education can also be supported by the private sector initiatives at the bottom of the pyramid so that we first get the ability to create productivity up for individuals in their villages in urban areas so that we can deal with the problem both of consumption and production at the same time.

The second challenge is if you want to create the capacity to consume you must have new and novel business models, and there are several ways in which people have tried to do it. One is easy payments, access to credit so that people can buy their goods and services that they want on the basis of easier monthly or quarterly payments. This is a well-known and proven system so that is not a major issue. The second thing which I think is very interesting is instead of asking people to pay a bulk sum at the beginning of consumption, only allow them to pay on the basis of use. Therefore the focus is on access and not on ownership. This is why the cell phones have taken off because people can buy a card with the amount of money that they have and they only pay for use. And the same thing is true in the western world on coin-operated laundromats. The question is if it can have coin-operated laundromats why not coin-operated PCs, why not coin-operated cell phones, why not coin-operated anything that people want to have access to?

A more interesting innovation has been what has today come to be termed as single serve. If you think about what you and I do, we buy, for example, large bottles of shampoo or pickles or medication - aspirin for example because we can afford to use cash as a way of inventorying convenience. Poor people don't have cash and not certainly enough cash so that they can inventory convenience with it. But they are willing to go to the village shop as frequently as is necessary. So what if we can provide a single serve? A single serve of shampoo, single serve of toothpaste, or certainly aspirin or pickles or ketchup. This has become a revolutionary idea in most parts of the world especially in the poor countries. For example 60 per cent of all the shampoo sold in India is sold in single serve. So is aspirin or ketchup. This is another way of creating the capacity to consume. People only consume when they have the cash, when they can afford it, and they don't mind the difficulty of frequent trips.

And finally how do we dramatically alter the cost? If you look at cataract surgery, it costs about \$3,000 in the United States. The question is how do you reduce the cost

to something that is much more affordable for the poor in a country like India? Typically and ideally the cost should be zero but then there is no business. If the cost is zero it has to be totally philanthropy. So the question therefore is how to make it available for free for people who are very poor and can't afford anything and charge a reasonable amount for most people who can afford it? So Aravind Eye Care System, for example, operates one of the largest eye care facilities in the world. They look at 1.5 million outpatients, do 250,000 surgeries per year. Clearly this is one of the largest in the world, or clearly the largest but they charge 60 per cent of the people nothing at all. It's totally free. And 40% of the people pay anywhere between \$30 and \$50 depending on what facilities they use and most of the payment that is done beyond \$30 or \$50 is for the quality of room, the air-conditioned rooms or special services which are more like living in a hotel rather than in a hospital.

So, how do we reduce costs from \$3,000 in the United States to \$30 to \$50 in India? That I think becomes the critical question. The same thing is true for heart surgery, the same thing is true for a wide variety of ailments. This is not just about wage arbitrage. This is about fundamentally rethinking how the businesses operate; what are the business processes; how to de-skill the work, how to reduce the capital intensity of the business, how to get specialisation so that you become world experts at doing one thing at a time, not a general hospital, so that there is a wide variety of tools and techniques that are being invented by companies like Aravind Eye Hospital to reduce costs dramatically.

So, there are many ways in which we can create world-class products and services to serve ordinary people at the bottom of the pyramid by creating easy payments, lower costs, single serve, paper use and direct distribution using civil society organisations to cover the last mile. At the same time, we have to create the ability to produce and become producers for not just a village but for the regional, national and global markets. How can we do this? There are some fascinating examples. One of them is Amul which produces milk and milk products in India. They cover pretty close to 10,000 villages and there are 2.2 million farmers who are involved. Every day the women with two or three buffaloes bring their milk to a common collection centre in the village where the milk is collected, weighed and measured and she is paid promptly so that there is motivation for them to come back every day, morning and evening, so they get cash right away. The milk that is collected in each village is taken to central processing facilities with the refrigerated vats where the processing facilities are large, world-class and could be as good as anything in Wisconsin or the Netherlands. Then the marketing is done both nationally and globally. Amul, which initiated this 50 years ago is today one of the largest producers of raw milk and processors of raw milk in the world. They do between 6.4 to 6.6 million kilograms of milk every day. And their sales are pretty close to \$900 million. Their products can be bought in the United States, on the Web, even though it is produced by small farmers in villages in Gujarat. So what is happening here? If we just take Amul as a case in point, we have connected subsistence farmers with two buffaloes in remote villages of India through a process of logistics to both national and global markets. Therefore as a micro-producer of milk, in this case, I am connected to global markets, therefore I can get reasonably fair prices. And Amul is a co-operative. Therefore, there is even greater incentive to make sure that people are paid fairly. They own the place. A new modern-day variation of the same process is what is called ITC e-Choupal. ITC is a global company and is one of the largest companies in India and they are in the business of buying wheat and soya bean in large quantities from farmers and then processing them. They decided to put one PC in each village so that the farmers could access prices and understand when to sell and when to hold. This is how we have started. The farmers get a better price for the produce and the company gets a better access to farmers and

therefore they can aggregate and reduce the logistics cost through intermediaries. As this process has evolved this company has close to two million farmers, all subsistence farmers in India, but the products that they sell go through the company and get access to both regional, national and global markets.

So there is an opportunity here by making sure that subsistence farmers in highly distributed environments get access to information, access to logistics and distribution to help improve the quality of their products and can become part of the global enterprise and global trade. Therefore both as a consumer, as a micro-consumer and as a micro-producer I can participate without moving out of my village in the global market place. This is one way of democratising commerce and these companies are not doing it for charity. They're doing it because they're able to make a significant contribution margin and also create wealth in the process.

The third piece of creating global commerce and at the same time creating a democratised commerce is how to make opportunities totally locally responsive so that it reacts and responds to the needs of the village, the needs of the poor people wherever they may exist. It is not a solution that is imposed by somebody, it is not an elitist view of poverty but where people have to make their own choices. At the same time how do we create global standards so that what they get is of global quality? Global standards do not mean luxury. It means standards of sanitation, standards of quality that you and I would have no problem accepting. A good example is McDonalds. McDonalds provides the same standards of quality and they are global standards of cleanliness and hygiene and the way food is prepared. It's not a luxury item. In some parts of the world it may be seen as such, but it's not a luxury product. So the question is, global standards are critical. At the same time local responsiveness is critical. And the consumers must have a role in creation of value. They must be able to create their own value rather than just be told what they can have and cannot have.

A good example of this is emerging in micro-finance. Most micro-finance companies go through self-help groups or NGOs. For example typically in India, large companies lend money to self-help groups, not to individual members of the self-help group. These self-help groups as a collection decide who among them will get the money and for what projects. So, in a very interesting way it is totally locally responsive because a bunch of 15 women sitting together decide who among them will be supported and for what projects and with how much money. So, that is as local as you can get. At the same time the sources of funds and the quality of products and services come from large national and international companies so that you get global standards and national standards of quality but extremely locally responsive opportunities for the people at the bottom of the pyramid.

So the three aspects of micro-consumption of world-class products and services at affordable prices, micro-production and getting fair wages and access to global markets and finally, new government systems which allow you to be both locally responsive and at the same time imposing global standards seem to be emerging. This is the great excitement about democratising commerce. The innovations that are taking place at the bottom of the pyramid are not only in creating world-scale with highly decentralised manufacturing as in the case of Amul, creating market-based ecosystems where the company cannot operate by itself without the active support of the community and civil society organisations so that instead of being adversaries on the outside, civil society and the large companies can work together in the interest to serve and therefore support each other's agenda of poverty alleviation, and building capacity at grass roots levels so that the self-help groups learn leadership skills, learn how to make choices; resolve conflicts; collect interest; make investments,

negotiate with large companies - all of them are happening simultaneously. Needless to say, many of these experiments are not fully scaled; some of them are in their infancy. But there is enough evidence to show that it is possible by engaging directly with the five billion forgotten people as consumers, as micro-producers, as people who can make choices for themselves, as people who want to lift themselves out of poverty. And what they are asking us to do is give them a chance and give them the freedom to decide how they will want to lift themselves out of poverty. Just by starting with those simple premises, we can make a dramatic change to the lives of a large number of people. But what is more interesting, just like I started talking about what has happened in the connectivity arena, where just five companies in one country called India have produced \$75 billion plus in market cap, this is going to get repeated. If you look at what has happened to wireless, the same thing is true in sub-Saharan Africa; it is true in South Africa, where significant market cap and market value has been created by cell phone companies. It is going to get replicated in a whole variety of areas, be it in micro-finance, be it in fast moving consumer goods, education, health, energy and certainly in housing. So the opportunity is phenomenal and I think is going to make a significant difference to the way we think about strategy.

I want to pause for a minute and then reflect on what the implications of this are. If for the first time five billion people can be part of the global market place it is going to create the next engine of growth for everybody. This engine, once it gets primed and goes beyond the inflection point, is almost unstoppable. Because these five billion people have to be moved from the unorganised inefficient sector to the more organised and efficient sector but in fundamentally a new way. This is not about taking western models or models from the developed world and displacing what is native, what is old and what is traditional. What this talks about is fundamental innovations, not only in products and services but in business models.

So we have the opportunity to build new business models that are very different and distinct from what we have ever known. So not only is it the engine of great growth, profitable growth, but it is also the engine of innovation and change and I believe that when we start innovating at the bottom of the pyramid many of the innovations will flow back to the developed world as well.

So creation of value through innovation is fostered by participating here. The third, which I think is equally important, is we cannot have in the 21st century a society which does not pay attention to five billion or 80 per cent of people who do not get the ability to participate in the benefits of globalisation. If we just leave them alone and do not pay attention to them I think it is very hard to maintain both peace and some form of law and order. If you look at where the conflicts are around the world, whether it is in Africa or in South-east Asia, most of these places where conflicts erupt are places where there is not only poor governance but a lot of poverty. I think we have to create the hope and the aspiration for people that tomorrow can be different and they have the wherewithal to make a difference to their own lives. Because today they can get access to products and services that are affordable and available on a continuous basis and we have to create the awareness that the world has not forgotten them.

So, it is the obligation of people who are a lot more privileged not to look at it as charity but look at it as an opportunity for not only growing profitably but doing well and doing good at the same time. And finally, I would say that this is going to be one of the largest opportunities we have for making a difference to not only what is happening around us but around the world.