

Strategizing for BOP Markets

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The base of the pyramid (BOP) has more than 65% of the world's population and should be seen as the last frontier of new markets. However investing in BOP markets is risky and benefits elusive. BOP strategic model requires a change in mindset by corporate executives from emphasizing short term market performance to developing a long term strategic view of the market. This study analyzes viable strategic themes for the BOP market. Six strategic themes comprising of entrepreneurship mindset, innovation, developmental pathways, logistics, marketing and collaboration are identified and applied in the strategic process of the pharmaceutical industry.

INTRODUCTION

There has been increased attention by scholars and practitioners on base of the pyramid (BOP) markets in the recent past. BOP markets comprise of over four billion people that survive on less than US \$2 per day (Prahalad, 2012). Collectively, BOP markets have a purchasing power of more than \$5 trillion. More recent studies show that 68.4% of the world's population that forms BOP markets owns 4.2% (or \$8.2 trillion) of the total wealth while the top 0.5% of the population owns 35.6% (or \$69.2 trillion) of the total wealth (Shorrocks et al., 2010). These markets are based in Africa, Asia and Latin America, transcend different countries, cultures, ethnicities and educational attainment and are by no means homogeneous. However, the BOP market continues to be underserved, inaccessible, unexploited and in many cases not fully monetized. Despite these constraints, BOP markets have witnessed strong growth in population, disposable incomes and the distribution of these incomes. On the other hand, multinational corporations (MNCs) have increased their interest in BOP markets, not as a source of basic raw materials but as a viable market. MNCs seeking entry to BOP markets are confronted with unique competitive conditions as they evaluate strategic options. Few studies have attempted to gain a deep understanding and develop theoretical formulations that are specific to BOP markets.

The purpose of this study is to identify strategic themes that are relevant for BOP markets and develop a BOP strategic process. This study makes a contribution to the expanding literature on BOP by developing a BOP strategic framework. The model develops a strategic process, specific to unique BOP markets. Hart and Dowell (2011) observe that despite corporate interests and practitioner-oriented literature, there is a dearth of scholarly research on BOP. This study, in part, responds to this clarion call. The study also submits a non-benevolent business case for investing in BOP markets. While previous studies have highlighted the potential for BOP markets, they have focused on micro-perspective elements of the market. Social and moral rationale for investing in BOP markets are relevant but insufficient catalysts for meaningful investments. It is our considered position that the total BOP market has gathered sufficient critical mass to warrant the designation of the last frontier. Finally, the study examines

opportunities for a select mature industry. The study identifies a specific industry, the pharmaceutical industry that is relevant for BOP customers yet inaccessible in many aspects. big pharma is an ideal case of a mature, western-oriented industry that is currently confronted by a perfect storm of environmental and competitive threats and has to rethink its strategic options in order to survive. One of the urgent needs in BOP markets is availability of drugs. The need for effective drugs to treat basic illnesses, lifestyle diseases and tropical diseases is overwhelming. Despite this need, big pharma is largely absent in BOP markets. BOP strategic themes and a strategic process are developed in this study.

LITERATURE REVIEW

Following Prahalad's seminal work on BOP markets and subsequent advancements (Prahalad & Hammond, 2002; Prahalad & Hart, 2002; Prahalad, 2004; Prahalad, 2012), there has been increased attention on BOP markets. BOP markets have unique competitive environments, competitive dynamics, geographic and sociocultural contexts, rendering mainstream strategic frameworks insufficient in facilitating effective strategy. Few studies have developed strategic formulations that are relevant to these markets, with many available strategic formulations focusing on charity and benevolence rather than competition.

The attraction of investing in BOP markets has not gone without criticism. This is partly understandable, given the chequered history and competitive conditions of poor economies around the world. Some scholars have questioned the viability of investing in BOP markets (Bruni Celli & Gonzalez, 2012; Karnani, 2007). Karnani further states that the size of opportunity may have been overestimated, with little empirical evidence of transitioning from poverty. One of the cornerstones of BOP investments is via MNCs (Gordon, 2008). However, there is no evidence that MNCs alone can lead to growth of BOP markets. Consequent to MNC investments are poor vulnerable consumers that cannot be protected by free markets (Karnani, 2007, 2009). Besides MNCs, other studies have been focused on 'micro-strategies' such as micro-financing, micro-marketing and small-scale enterprises that appear to be token attempts at self-sufficiency and benevolence rather than competitive strategy. Evidently, market failure and the role of governments in stabilizing the macro-environment have been ignored. While some of the criticism has merit, recent data suggests that BOP markets have the fastest population and market growth. Prahalad (2004) further argues that BOP customers are willing to pay more for quality/reliable products. Competitive data further supports BOP markets as the remaining competitive frontier (Nakata & Weidner, 2012). From a geopolitical standpoint, Hammond (2002) argues that inclusiveness enhances global security. Table 1 below summarizes recent arguments that have been advanced on investing in BOP markets.

Acknowledgment of BOP potential has not led to a corresponding interest in exploiting those opportunities. That may, in part, be due to corresponding challenges highlighted in Table 1. Looking at the obstacles confronting BOP markets (London & Hart, 2004; Rivera-Santos & Rufin, 2010; Reficco, 2012 and de Soto, 2000), it is clear that strategic business frameworks that have worked well in western markets are, in many cases, not suited for BOP markets. Developed markets in western countries are characterized by structure, homogeneous customers, informed customers, regulation, property rights, effective infrastructure and technology. These conditions are often absent in BOP markets.

TABLE 1
ARGUMENTS IN FAVOR OF AND AGAINST INVESTING IN BOP MARKETS

Case for BOP markets	Author(s)
Purchasing power: 65% of global population and \$5 trillion market	Prahalad, 2012
Fastest population/market growth	
Hidden capital and wealth in informal economy	
Survival/viable	Hart, 2005
Inclusiveness enhances security	Friedman, 2000; Hammond, 1998
Consumers willing to pay more for quality/reliable products	Prahalad, 2004
Most significant remaining global market.	Nakata & Weidner, 2012
Case against BOP markets	Author(s)
Undeveloped formal institutions: capital markets, infrastructure, contracts and enforcement and property rights.	London & Hart, 2004
BOP networks are less centralized, wider in scope, less dense, high-density clusterings, more structural holes; direct and informal, have a multiplicity of domains of interaction, and diversity is greater.	Rivera-Santos & Rufin, 2010
Doubts on profitability of BOP ventures	Bruni Celli & González, 2010
Barriers impede implementation of BOP projects by MNCs. Internal barriers include structure and incentives, process and cognition. External barriers include misalignment with core competencies and attractiveness of BOP market segments.	Reficco, 2012
BOP markets are unprotected by established institutional rules.	de Soto, 2000
Size of opportunity is overestimated.	Karnani, 2007
Little empirical evidence of success out of poverty.	Karnani, 2007; Banerjee and Duflo, 2007
Assumes path to prosperity and economic growth via MNCs.	Gordon, 2008
BOP strategies do not protect poor vulnerable consumers; overemphasizes microcredits; underemphasizes role of government in ameliorating market failure and alleviating poverty.	Karnani, 2009

Scholars have increasingly called for more effective business models that can be applied in BOP markets (Rangan et al., 2007; Viswanathan et al., 2009; Chikweche & Fletcher, 2012). Prahalad identified BOP markets as a source of radical innovation (Prahalad, 2012). The challenge was to develop viable business structures for unorganized and fragmented four billion people (or 65% of the world's population) earning less than two dollars a day but with a collective market power of \$5 trillion. Through awareness, access, affordability, and availability, managers would create a crucible of innovation. Unique solutions for unique BOP markets would be achieved by working within constraints to create an "innovation sandbox" and consequent viable businesses.

A SYNTHESIS OF BOP STRATEGIC MODELS

Few studies have attempted to develop unique strategic models that are likely to work in BOP markets. Recent studies by Webb et al.(2010) suggest the need for a business model that exploits

entrepreneurial opportunities through partnerships with nongovernment organizations (NGOs). Unlike MNCs, NGOs are deemed to have localized knowledge, social embeddedness within multiple informal networks, and ambidexterity in dealing with diverse stakeholder groups. It should be noted that NGOs' main objectives are not necessarily economic and any economic benefits would be complementary to the primary social benefits. Simanis & Hart (2009) suggest an embedded innovation paradigm (EIP) framework for BOP markets. In this framework, innovation is derived from the creation of new communities; diverse people working together to create and sustain interdependent lives. Innovation becomes the relationship that binds communities together. EIP consists of latent potential focus, relationship-based value and transformational stakeholder engagement. Ultimately, there is a sustainable competitive advantage through business model intimacy between consumers and producers. Nakata and Weidner (2012) weigh in on the BOP markets as the last frontiers for business. Based on theories of innovation and poverty, they propose that certain new product characteristics, social context dynamics, and marketing environment approaches moderate or counter some of the limits of poverty, making adoption of new products possible. A recent study by Schrader et al. (2012) suggests a strategic process framework that modifies elements of traditional strategic process models to align with BOP market conditions. Key themes that are identified for the development of idiosyncratic solutions include strategic implementation, supply chain management and sustainability outcomes. Similarly, Reficco (2012) proposes a radical adjustment of processes and products to cater for this market. However, rather than looking at the BOP as a separate market, Reficco suggests a more feasible option of incorporating low-income groups in established markets as a first step. A related study by Gollakota, Gupta and Bork (2010) presents a two stage model that involves a deep cost management strategy. The first stage involves a focus on core customer value, and holistic operations reengineering. The second component involves a deep benefit management strategy, involving value reengineering, partnering for excellence, and creating inclusive channels.

A review of extant research on BOP markets shows common strategic themes. An entrepreneurship mindset is an essential component of doing business in BOP markets. Unique environmental conditions call for new ways of competing effectively. Firms seeking entry must first identify and exploit new opportunities (Lumpkin & Dess, 1996; Shane & Venkataraman, 2000). While opportunities may be visible, exploiting these opportunities requires considerable entrepreneurial skill due to the challenges highlighted in Table 1. While western markets are saturated, there is considerable scope for basic products and services in BOP markets. One only needs to proactively search for new products (Zahra, 2008), modify existing products or increase awareness of existing products to generate effective demand. A key component of entrepreneurial mindset in BOP markets is identifying and exploiting local resources. While capital, technology and infrastructure are scarce, there is an abundance of natural and human resources that can be harnessed through hybrid technologies, to create competitive advantage. Local partners and actors can be a good source of tacit knowledge of the environment. Alvarez and Barney (2007) describe the role of local actors in the creation of iterative learning processes; based on the theory of parallelism in the discovery and creation of entrepreneurial action.

Innovation resonates with most BOP strategic formulations. While MNCs' strategies are effective in western and emerging markets, the BOP segment has consumers with unique unmet needs, limited incomes and in many cases limited sources of information. Consequently realistic business models have to come up with innovative solutions, in addition to a price-performance envelope (Prahalad, 2012) that effectively focuses on high volumes and thin margins, not as a ploy to gain market share, but a sustainable model.

A notable challenge of doing business in BOP markets is the undeveloped infrastructure. This has implications on every aspect of the supply chain. Most BOP markets are based in tropical countries causing special challenges of packaging, storage and preservation of products. In some cases, a culture of poverty, corruption and violence leads to added costs of logistics.

The attraction of BOP markets is in the massive population, population growth and income growth rates. Within BOP populations there is gross income inequality, a large section of non-monetized sectors and underdeveloped credit markets. This potential market is unstructured, heterogeneous, diverse and

often spatially dispersed, creating a tyranny of numbers especially in designing marketing strategies. Consequently, MNCs have to develop innovative solutions to access the customers and develop market power. The overarching marketing theme is one of value creation through relationships and collaborations with customers. This perspective of co-creation ensures joint value creation through co-construction, learning, problem-solving and local adaptation (Prahalad & Ramaswamy, 2004). Co-creation requires a constant presence and interaction between the MNCs and relevant stakeholders.

Criticisms of current BOP theories include the assumption of a functioning free market system and the notion that poor vulnerable communities have consumer power. Some scholars have also highlighted ethical implications of exploiting vulnerable consumers (Bardy et al., 2011). These issues are germane and have to be addressed as part of the strategizing process. There is a need to mitigate market failure by developing alternative governance systems, absent effective market institutions. Early work on BOP consumers has advocated for a capabilities approach that focuses on empowerment of BOP customers to exploit available opportunities rather than rational economic choice (Sen, 1885, 1999). Arising is a need for collaboration with governments and local communities to support alternative institutions and protect vulnerable groups. Ansari et al. (2012) have advanced the concept of community-centric BOP approaches that analyze social impact of business ventures. Roxas and Ungson (2011) have proposed the alignment of commercial goals with the well-being of the disadvantaged. Beyond the market and consumers, there is a real need for collaboration with local governments and communities to tap into local tacit knowledge, utilize local resources that are often much cheaper and mitigate business risk. Unlike developed markets, collaboration is an essential component of strategizing for BOP markets.

BOP STRATEGIC PROCESS: THE PHARMACEUTICAL INDUSTRY

The section highlights the BOP strategic process within the pharmaceutical industry. Big pharma offers a relevant context due to its competitive environment. The pharmaceutical industry has undergone significant changes in the past decade. Hypercompetition, market saturation, depleted R & D pipelines and in some cases declining populations in western markets have forced big pharma to reevaluate their strategic positions. Western pharmaceutical markets expected to grow by 3% in the next three years; while BOP markets are growing at 14% (Edwards, 2010). In addition, big pharma is faced with a serious threat of depleted drug pipelines (Tralau-Stewart et al, 2009), especially for blockbuster drugs. It is estimated that big pharma stands to lose \$106 billion in sales by 2016 due to the patent cliff (Jimenez, 2012). Despite these challenges, there is constant pressure by shareholders to perform. This perfect storm has led big pharma to reexamine its business model and also expand the field of vision. Many firms in the big pharma category are repositioning to seek dominance in pharmerging and BOP markets. To be competitive in this space, these firms will need to undergo significant strategic realignments.

While the market potential for BOP markets is indisputable, these markets share some characteristics that distinguish them from western markets where most big pharma have traditionally hedged their bets. The sociopolitical structures and ideology call for more intervention in primary care. Consequently respective governments are more likely to play a direct role in designing and implementing primary care strategies. The traditional business model of big pharma in western markets has taken a structured path characterized by blockbuster drugs and a path-dependent approach. This is unlikely to be sustainable in western markets in the future or effective in BOP markets as the chosen strategy. BOP markets are increasingly dominated by generics. This has implications on R & D strategy, developmental pathways and marketing strategies. Unlike western markets that have more egalitarian income distribution with a significant middle class population, in BOP markets, roughly only 10% of the population belongs to the middle class, while the rest is largely poor, less educated and living in rural areas. This has implication on whether and how big pharma will choose to compete in these markets. Some big pharma entities have chosen a merger and acquisition strategy as a means of developing capabilities and market power in BOP markets. Others have adopted various forms of alliances, while a few have selected a brick-and-mortar approach.

Clearly, there is enormous potential for big pharma in BOP markets. There is also a reality that these markets cannot be ignored. The real challenge is identifying and operationalizing viable strategies while addressing the obstacles and risks. Following emerging themes from the literature, we have identified six processes that are critical to an effective BOP strategy by big pharma. The six sub-processes are as follows: an entrepreneurship mindset, innovation, developmental pathways, logistics, marketing and collaboration.

Entrepreneurial Mindset

The first step in engaging BOP markets requires a managerial strategic orientation towards BOP markets. By developing an entrepreneurial mindset; a few large pharmaceuticals are beginning to see pockets of opportunity in BOP markets. While data shows BOP markets as future growth markets, exploiting this opportunity requires a shift in mindset and a deeper understanding of unique market conditions, medical/patient needs and oncology. A shift in mindset also involves a change in perception of BOP customers from being beneficiaries of benevolence to customers.

Innovation

An entrepreneurship mindset will need to be supported by innovation. Big pharma often has intimate relationships with stakeholders in BOP markets. These networks can be leveraged to understand the real medical needs and the most efficient modes of delivery and also utilize local resources for R&D, manufacturing, sales and other value chain activities.

Developmental Pathways

In most BOP markets, big pharma has chosen entry modes that involve exporting, acquisition of local pharmaceuticals that are mainly involved in manufacturing generics, and in a few cases, forced licensing. However, a long term strategic presence can only be guaranteed through a deep low-cost model achieved by adapting innovative hybrid and no-frills technologies. This essentially necessitates a relocation of drug development pathways. Potential areas include local research, local raw materials, local clinical trials and manufacturing. Big pharma has something to learn from other industries such as consumer and cosmetics that have tropicalized their value chain processes. Such a strategic shift is guaranteed to ensure adaptive and absorptive capacities and consequent capabilities. Ignoring to build internal capabilities for competing in BOP markets will ultimately lead to unintended consequence of inability to compete with local MNCs, especially for the generics business segment.

MNCs setting up businesses in new markets have to confront challenges of setting up efficient logistics. The easy options include using resellers or existing networks. However the liability of foreignness in other areas such as tropicalizing products, changing dosaging levels and scaling has to be confronted as an internal business imperative.

Marketing

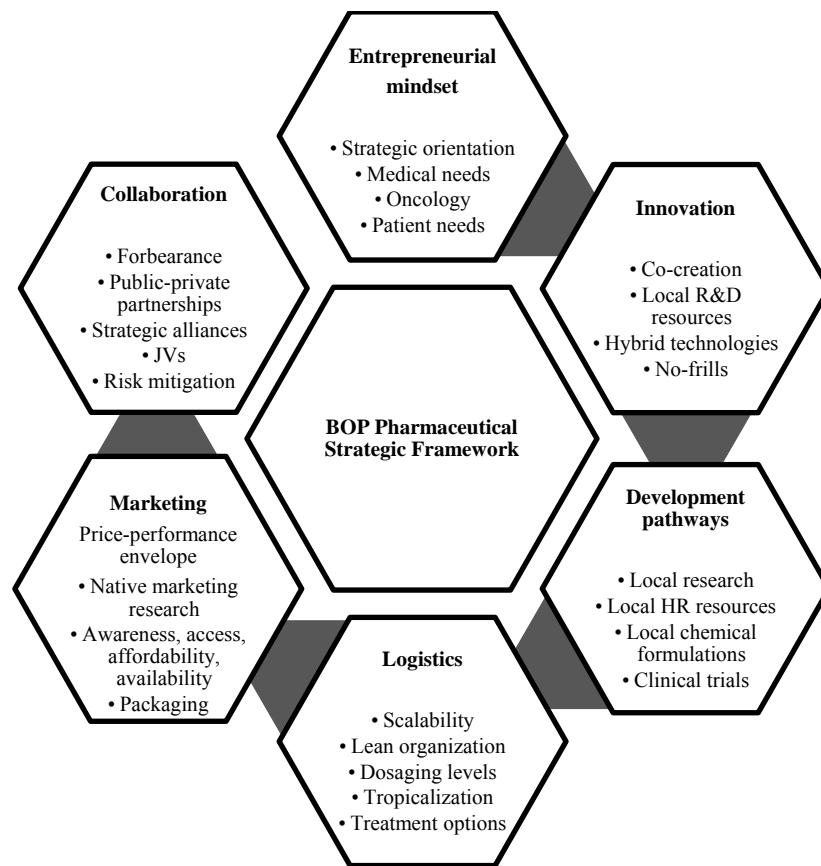
A key challenge for big pharma is effective marketing. Marketing products to poverty-stricken communities with limited education and infrastructure requires creative strategies. Scholars have highlighted refocused marketing towards these consumers (Yujuico & Gelb, 2010). For example through co-creation (Prahalad & Ramaswamy, 2004) emphasize on the value of co-creation by allowing the customer to co-create value through an active dialogue, context and a personalized experience. Co-creation essentially involves community-based marketing in BOP markets. Complementary to co-creation is a need to develop a proactive market orientation, which addresses the latent needs of customers, opportunities for customer value of which the BOP customer is unaware (Narver & Slater, 1999). Finally the marketing strategy will need to address a price-performance envelope that focuses on volume over price, develop local marketing research capabilities, create an engaged customer base through awareness, access, affordability and availability (Prahalad, 2012) and tropicalized, yet affordable packaging.

Collaboration

Institutional barriers have often discouraged MNCs from investing in BOP markets. For big pharma, there are additional special challenges resulting from underfunded public health sectors and undeveloped private healthcare systems. There is a real case of market failure that can only be ameliorated through creative collaborations and alliances with stakeholders. Following transaction cost traditions, big pharma will need to develop a long term strategic view of BOP markets where contractual agreements are negotiated in realistic terms, backed by credible commitments and safeguards against hold ups and opportunism. Examples of such governance modes include joint-manufacturing with local governments to supply the public healthcare system, R & D collaborations with local medical institutions and engagement of community groups and NGOs to develop and deliver medicines for basic diseases that are prevalent in BOP communities.

Figure 1 below is a strategic process for big pharma in BOP markets. While the process is sequential for parsimony and illustrative purposes, there is an implicit network of relationships across the process to ensure feedback, knowledge flows and performance improvement.

**FIGURE 1
STRATEGIC PROCESS OF BIG PHARMA IN BOP MARKETS**



IMPLICATIONS FOR BOP THEORY

BOP markets will play an increasingly bigger global role in the years to come. The study highlights a need for a more inclusive approach in developing strategic theories/processes. From a strategic leadership

perspective, there is a need to examine MNC executives' strategic orientation, the field of vision and perceptions about BOP markets. The study also highlights a need to exploit MNC's dynamic capabilities by reorganizing processes, paths and assets in BOP markets. Teece (2011) highlights three clusters of adjustments that are essential ingredients of dynamic capabilities in a global market; sensing, seizing and transforming. These are important reference points for MNCs that are interested in BOP market entry. The third theoretical implication is the value-chain analysis (Porter, 1985). Due to the significance of a new price-performance envelope and deep cost cutting requirements, successful execution of BOP strategy largely depends on how well the firm is able to identify and implement deep cost cutting measures across the value chain.

Due to underdeveloped property rights institutions, capital markets and business risk, entrants to BOP markets will need to develop effective governance modes in the traditions of transaction cost economics (TCE) that have been articulated in the literature (Williamson, 1885; 2012). TCE offers the framework for understanding BOP markets from a long term strategic view of the nascent market, rather than a narrow short term perspective. TCE also offers a framework for setting up safeguards to mitigate insufficient property rights laws, opportunism and cases of market failure that are likely to arise.

To develop better theoretical formulations for BOP markets, it is essential to include BOP markets as an integral part of the competitive environment while developing strategic theories. Practitioners have recognized the significance of BOP markets and made moves towards that end, however, there is less than corresponding interest by scholars in formulating and testing relevant theories. The situation is beginning to change following increased growth and FDI flows to BOP markets. Finally, there is a need to review the strategy curriculum to include BOP markets as a key part of the competitive environment rather than a discretionary market.

IMPLICATIONS FOR PRACTICE

The study has reviewed dissimilarities between western and BOP markets and push factors that have caused strategic positioning towards BOP markets. Meaningful engagement by big pharma requires unlearning the gestalts of knowledge that have been effective in western markets and adopting new mental models that take into account institutional voids, risks, resource base and capabilities of BOP markets.

BOP markets present unique challenges to practitioners. We have identified strategic themes that are relevant to BOP markets. We have also highlighted the opportunities and obstacles of strategizing for BOP markets. Continuing saturation, reduced demand for product categories in mature industries, and pressure from shareholders are all push factors for MNCs to seek new markets. On the other hand, targeting BRIC markets exclusively or high income groups in BOP markets may have unintended negative consequences in the long term since as has been observed, large populations of BOP customers are slowly transitioning to higher income levels. Within emerging and developing markets, there are homegrown MNCs that will, in the future pose serious competition to western MNCs. This phenomenon is evident in the pharmaceutical industry where a robust generics pharmaceutical category is competing with mainstream big pharma on all fronts. By maintaining a presence in BOP markets, MNCs are in a better position to strategize for BOP markets. A presence in these markets provides context for understanding customer needs, entrepreneurship and innovation. Literature is abound with anecdotal evidence of how Unilever and Proctor and Gamble have been able to develop local products through interactions with BOP markets.

CONCLUSION

BOP markets have been perceived as the last frontier. However investing in BOP markets is risky and benefits elusive. BOP strategic model requires a change in mindset by corporate executives from emphasizing short term market performance to developing a long term strategic view of the market. A new price-performance envelope that emphasizes volume over margins requires resilience and initial

adjustment to lower margins. Due to unregulated markets and ineffective property rights laws, there is a need to forge hybrid structures and integrative risk mitigation strategies. This requires more collaboration and co-operation with competitors and governments rather than a winner-takes-it-all approach.

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