Doing BOP Business in South Africa

Based on a *Study Trip*
to Johannesburg, March 2010
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Johannesburg, South Africa
The Base of the Pyramid (BOP) concept argues a compelling case for today’s businesses to ensure tomorrow’s success by embracing the poor as both prospective business partners and future consumers. South Africa represents such a market.

This publication is based on a study trip to Johannesburg in March 2010, where a group of Danish and South African companies came together to explore the potential for doing BOP business in South Africa and especially within the sectors for housing, health, and consumer goods. It aims to clarify the opportunities and challenges in the South African BOP market as well as provide new ideas, models, and inspiration for companies to achieve success in this market.

The publication is prepared by DI International Business Development (DIBD) in cooperation with the Foundation for African Business and Consumer Services (FABCOS) and the Embassy of Denmark in Pretoria. Essential contributions have been received from the Gordon Institute for Business Science (GIBS), the South African BOP Learning Lab, and all the participants who took part in the study trip. Their kind participation and willingness to dedicate time and share their experiences have made this project possible.

We hope this publication will inspire more companies to go ahead and explore their real BOP business potential in South Africa and the region.

Copenhagen & Johannesburg, June 2010

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WHAT IS THE BOP?

Four billion people, a majority of the world’s population, constitute the base of the economic pyramid (BOP). They all live on low incomes below $3,000 per capita in local purchasing power.

The aggregate purchasing power and consumer behavior mean that this vast group of people make up a significant market segment. Selling sustainable products to BOP markets, companies can significantly expand their consumer base and at the same time empower poor people to be lifted out of poverty.

Strategies to successfully enter BOP markets challenge the traditional business models that have worked well in Denmark and other high-income countries. The unique conditions in BOP markets differ from the economic logic that dominates the Danish companies’ approach to the developed markets where high margins predominate. The BOP markets, on the contrary, rest on low margin per unit and high volume.

In order to successfully manage business conditions at the BOP, companies must be innovative in their approach and customize their products, production, and prices to the realities in BOP markets. Companies chasing high margins will miss out on the opportunities at the BOP, while companies that think out of the box, innovate, and focus on overall profits are likely to thrive at the BOP.

An increasing number of Danish companies are already finding ways to profit from the BOP. However, entering the BOP market can be challenging. Especially for companies who are not familiar with doing business in developing countries and targeting low-income consumers.

The purpose of this publication is to facilitate the process of entering the BOP markets by bringing hard evidence and personal experiences from the BOP in South Africa to the attention of Danish companies.
Base of the Pyramid

- **Global Population**
  - Per Capita Income (PPP)
  - 800 million: > $15,000/yr
  - 1.5 billion: $3,000 – $15,000/yr
  - 4 billion: < $3,000/yr

**BOP facts**

- Four billion people live on low incomes at the Base of the Pyramid
- Significant development needs
- The commercial market is unexplored
- Individual purchasing power is low
- The number of consumers is high
- Competition is low
- BOP typically pays high prices for low quality
South Africa constitutes a vast and growing market. With a population of around 45 million people or seven million households, South Africa represents a $135 billion market for household consumption annually.

South Africa has a unique blend of first and third world economy. This means that the gap between rich and poor is enormous. In the large cities there is often only a few hundred meters between the wealthy suburbs and the poor townships.

Danish companies in South Africa have typically been oriented toward high-income consumers. However, if the poor are included on the list of potential customers, business opportunities increase significantly.

The majority of the South African people live at the lower part of the economic pyramid. It is estimated that approximately 30 million people, or two out of three, live at the Base of the Pyramid in South Africa on less than $3,000 annually in local purchasing power.

When the total buying power of the low-income consumer groups are calculated, the BOP in South Africa represents a $40 billion market – or one third of the entire South African market.

The South African BOP market constitutes a $40 billion consumer market.
BOP OPPORTUNITIES
The large poor population in South Africa have many needs that can be met by foreign companies. More than one million households lack access to water, more than three million households lack access to adequate sanitation systems, and 3.3 million households lack access to electricity.

In general, food dominates household budgets at the BOP. Other important items are housing, energy, and health care. As incomes rise, the share spent on communication and transportation grows accordingly.

The products and services available to the poor are typically ‘high-priced low-quality’. In other words, it is expensive to be poor. This is partly due to the traditionally limited competition in these markets, since only few companies target them. It also means that there are significant market opportunities for Danish companies in South Africa, who can provide affordable solutions to meet the demand at the BOP.

BOP CHALLENGES
Engaging in the South African BOP market also entails certain challenges. The single largest challenge is the limited purchasing power of the individual consumer. This means that companies must think in high market volumes and low margin per unit.

Other challenges are the inadequate physical and institutional infrastructure, which means that companies have to rethink the entire value chain from production to packaging, storage and distribution.

Finally there is a challenge concerning the geographic, economic, and cultural distance to the BOP. Therefore, to engage in the South African BOP you need skilled local partners to facilitate the entry to the market.

Naturally, the challenges at the BOP can be met and they are possible to overcome through innovative business models and local partnerships.
The purpose of the three day study trip to South Africa was to provide Danish companies with a unique opportunity to gain insight in living conditions and business opportunities in a typical BOP market. The programme focused on the three major BOP sectors: housing, health, and consumer goods, and it included visits to sites such as housing projects, health clinics, distribution centres, supermarkets, shops, and taverns. Most of the time was spent in the large township, Alexandra, located in Johannesburg with an estimated population of 750,000 people.

Before leaving for South Africa many of the participants were unfamiliar with the conditions at the BOP – both in respect to doing business and understanding the specific needs and preferences of the people. During the trip, the BOP was illuminated through interaction with local entrepreneurs and consumers, and new knowledge and ideas were brought to life.

“I observed that appearances matter a lot for the BOP. Integrity and pride are huge parts of cultural and social acceptance. So it was important to always present oneself with integrity and that means smelling good, having a decent haircut and good clothes. These emotive parameters will yield respect from neighbours. I had a chance to speak to one of our local security guards, and noticed how shiny his shoes were. Cheekily, I told him how noticeable his shiny shoes were and very proudly he told me he shines his shoes everyday! Intrigued I asked what his ritual was and he said that he spent 30 minutes every day polishing and shining. These efforts certainly weren’t a waste, his ritual of having well kept shoes gave him some pride in being noticed.”

Lisa Chong, Index.

Understanding the little things such as the status originating from products and services can be important for developing a business model which truly meets the needs at the BOP.
Also, by exploring public housing projects new BOP opportunities were identified. The Government has built hundreds of houses for the poor. Unfortunately, most are in such bad shape that they do not meet the actual need for a real home.

“It is important to realise that there’s a difference between a ‘home’ and a ‘house’. A house is four walls and a ceiling covering an immediate need, whereas a home is a place you own and in which you live. Most people support quality of life and well-being rather than survival. I’m afraid this was not a part of the public housing projects in South Africa, which was characterized by poor architectural and technical quality and therefore the houses will look and feel slummy, dusty, and unpaved after eight years. It doesn’t have to be that way.” Mikal Hallstrup, Designit.

Visiting a private health clinic in Alexandra gave rise to new ideas in the field of BOP health business. Designers who participated on the trip identified a number of low-hanging fruits for improving health conditions at the BOP by providing simple practical solutions.

“On a micro-level some of the needs addressed by the nurse can easily be solved by design! Such as privacy issues in the women’s clinic. For example, a simple soundproofing mechanism can be installed using very cost-efficient materials. Another problem was the occupancy of cubicles, and nurses and patients being interrupted. Again this can be solved by design.”

Liza Chong, Index

To conclude on how to initiate a BOP venture in South Africa, Roan Hammond from Connie F Marketing notes:

“The first step to do business at the BOP would be to find a capital partner with deep pockets! A lot of mistakes will be made along the way, but once you find your footing, I believe the returns will be large.”

Roan Hammond, Connie F Marketing

Some of the participants exploring a construction site in Alexandra, Johannesburg
HOUSING

11 pct. of the average BOP household spending in South Africa goes to costs related to housing. In addition, large public housing, electricity, and water projects are being initiated in South Africa, which makes the overall housing market very big.

Inadequate housing for the poor is a major problem in South Africa and 1.2 million households still live in informal settlements. In Alexandra alone there are an estimated 20,000 informal dwellings ("shacks"). In addition, access to water and electricity is insufficient in most BOP areas.

A response from the government has been to initiate large housing projects to meet the immediate needs of the poor. As a result, more than 2.8 million houses have been built and distributed among the poor. However, the needs are still enormous and the good solutions are scarce.

Visits to public and private housing projects in Alexandra showed that the houses were of very poor quality, despite the fact that they had recently been built. Keeping the building costs at a minimum not only diminishes the quality, it also reduces the commercial value of the house and hence the opportunity for the poor to use the house as e.g. collateral.

Building a home is much more than just setting up four walls and a roof. And if housing projects are to contribute to empower the poor more consideration must be given to ensuring quality.

It is apparent that there is a pressing need for proper management of building projects as well as supplying quality material for the building sector. These are areas were Danish companies could develop viable BOP businesses.
Business opportunities

- Management of housing projects
- Supplying building materials
- Energy solutions
- Water and sanitation systems
- Housing design and architecture
HEALTH

The BOP health market in South Africa (medicine, life-saving products, and health services) only make up around two pct., or $ 577 million of the total market. However, it is growing fast and the needs seem endless.

The average life expectancy remains low at 53.4 years. This is largely due to the high prevalence of HIV among ages 15-49 estimated at 18 pct. There is also a high burden of tuberculosis and cardiovascular diseases.

About 80 pct. of the South African population has access to essential health services within an hour. Human resources are largely available, but there are frequent shortages in terms of access to proper medication and health facilities. Pharmacies are an important entry point to the market as they are often in the front line of health care.

The DI study trip took the participants to a typical South African private health centre: The Alexandra Clinic. The clinic is dependent on Government and donor funding to provide free medical services to the citizens of Alexandra. It employees 30 staff and receives around one thousand patients every day through its casualty emergency room, medical consultation, maternity ward, HIV & AIDS clinic, and pharmacy.

There is an obvious potential for Danish companies to supply everything from painkillers to advanced x-ray machinery to the health clinics and pharmacies in South Africa. But there is also the potential of supplying practical solutions to improve the facilities for providing medical services.
Business opportunities

- Equipment for medical clinics
- Medicine
- Health care services
- Design of healthcare facilities
CONSUMER GOODS

The South African market for consumer goods predominantly consists of food & beverages, clothing, furniture, and personal care. Representing 55 pct. of the average BOP household expenditure, the market is by far the largest BOP market in South Africa, but it is also one of the more challenging to enter.

Private consumption by people living at the BOP in South Africa is centred on food. Maize flour, sugar, beans, sunflower oil, meat, vegetables, and sweets are typical products in basic basket. Also, beer and soft drinks are largely consumed by the South African BOP.

The market is already largely supplied by both national and international suppliers. However, there are still obvious business opportunities in the BOP food market – e.g. providing better low-priced food products, improving distribution and availability, as well as inputs for the agricultural sector.

The immediate challenges when entering the market is first of all the distribution into the small local shops, and secondly the evident consumer product loyalty. BOP consumers are generally very particular in taste and brand preferences. It can be difficult to introduce a new product without local assistance to facilitate distribution and promotion.

During the DI study trip, a visit was paid to the FABCOS Distribution Network. The Network buys preferred consumer goods in large quantities from national or international suppliers which they distribute directly to small shops in the townships using local trucks and drivers. The business model allows the Network to ensure affordable prices for the end-user and at the same time introduce new and better products in the market.

There is an obvious business opportunity for Danish companies in supplying food and beverages to the South African market. But a local partner is essential for achieving success.
Business opportunities

- Supplying high-quality low-priced food products
- Beverages at high quality
- Personal care and hygiene products
- Food processing machinery
Doing business at the BOP is in many ways ‘business as usual’ – knowing your customer, designing a product or service with a strong value proposition etc. However, it is important not to transfer traditional products and business models uncritically to BOP markets. BOP markets have certain characteristics that require innovative business modelling and design.

**A NEED IS NOT NECESSARILY A MARKET**
For instance, an obvious need such as water or medicine does not necessarily imply that a market will appear once the products are available. Many companies are surprised to learn that BOP markets are often not entered but need to be created through e.g. consumer education and local partnerships.

**PARTNERS ARE KEY TO SUCCESS**
Choosing the right local partners is also imperative for success. Partners can be like-minded businesses, but also NGOs, public institutions, schools and universities can enhance your chances for success by contributing with in-depth local knowledge and contacts. As a consequence these types of partners can create local support and legitimacy to your project.

**DESIGN INNOVATIVE DISTRIBUTION MODELS**
In addition, distribution is a key concern to many companies. Especially rural areas are often difficult to access. Increased transportation costs can ultimately make products too expensive for the BOP consumers. Therefore, innovative distribution models – using bicycles, small trucks etc. to reach the end users at the BOP – need to be designed carefully.

To get started with doing BOP business it can be useful to visualize the process in three phases: From idea and testing phase, over developing the actual business model, to scaling the project to other areas and regions.
DIBD (DI International Business Development) assists Danish companies that seek international growth by developing their businesses in challenging markets in Asia, Eastern Europe, USA, Africa, and Latin America. DIBD offers individual solutions on strategy, establishment, export, market analyses, comparative analyses, business plans, feasibility studies, financing, partner searches, contract drafting, and the enhancement of local business environments through co-operation with numerous Business Membership Organisations. DIBD has worked strategically with assisting Danish companies on the BOP markets for three years.

FABCOS (the Foundation for African Business and Consumer Services) is a Business Membership Organisation promoting the development of black business in South Africa. The uniqueness of the organisation lies in its focus on township and rural-based formal and informal businesses. It is financial independent and operates a number of companies as a means of intervening directly and practically for the benefit of its members.