

The Next 4 Billion

Characterizing BoP Markets

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THIS STUDY USES EMPIRICAL MEASURES to describe the behavior of low-income populations as consumers and producers. In aggregate, their purchasing power suggests significant market opportunities. By quantifying this market and describing its characteristics, we hope to stimulate business development and investment that can better meet the needs of these populations, as well as increase their productivity and incomes and empower their entry into the formal economy.

The 4 billion people at the base of the economic pyramid (BoP)—all those with incomes below \$3,000 in local purchasing power—live in relative poverty. Their incomes in current U.S. dollars are less than \$3.35 a day in Brazil, \$2.11 in China, \$1.89 in Ghana, and \$1.56 in India.¹ Yet together they have

substantial purchasing power: the BoP constitutes a \$5 trillion global consumer market.

The wealthier mid-market population segment, the 1.4 billion people with per capita incomes between \$3,000 and \$20,000, represents a \$12.5 trillion market globally. This market is largely urban, already relatively well served, and extremely competitive.

In contrast, BoP markets are often rural—especially in rapidly growing Asia—very poorly served, dominated by the informal economy, and, as a result, relatively inefficient and uncompetitive. Yet these markets represent a substantial share of the world's population. Data from national household surveys in 110 countries show that the BoP makes up 72 percent of the 5.575 billion people recorded by the surveys and an overwhelming majority of the population in Africa, Asia, Eastern Europe, and Latin America and the Caribbean—home to nearly all the BoP.



A BoP PORTRAIT living at the BoP

The BoP is characterized not only by low income—below \$3,000 per capita per year—but also by several other shared characteristics:

SIGNIFICANT UNMET NEEDS

Most of those in the BoP have no bank account or access to modern financial services—if they borrow, it is typically from the local moneylenders at very high interest rates. Most do not own a phone. Many live in informal settlements and have no formal title to their dwelling. And many lack access to water and sanitation services.

DEPENDENCE ON INFORMAL OR SUBSISTENCE LIVELIHOODS

Most of those in the BoP are poorly integrated into the formal economy, which limits their economic opportunities. As producers, they often lack good access to markets to sell their labor, handicrafts, or surplus crops and have no choice but to sell local employers or to middlemen who exploit them. As subsistence and small-scale farmers and fishermen, they are uniquely vulnerable to destruction of the natural resources they depend on but are powerless to protect.² In effect, informality and subsistence are poverty traps.

IMPACTED BY A BoP PENALTY

Many of those in the BoP, and perhaps most, pay higher prices for basic goods and services than do wealthier consumers—either in cash or in the effort they must expend to obtain them—and they often receive lower quality as well. For some services BoP consumers lack access altogether. The high cost of being poor is widely shared: it is not just the very poor who must walk long distances for water or firewood, or who often pay more for the transportation to reach a distant hospital or clinic than for the treatment, or who face exorbitant fees for loans or for transfers from relatives abroad.

Analysis of the survey data—the latest available on incomes, expenditures, and access to services—shows marked differences across countries in the composition of these BoP markets. Some, like Nigeria's, are concentrated in the lowest income segments of the BoP; others, like those in Ukraine, are concentrated in the upper income segments. Regional differences are also apparent. Rural areas dominate most BoP markets in Africa and Asia; urban areas dominate most in Eastern Europe and Latin America. Striking patterns also emerge in spending. Not surprisingly, food dominates BoP household budgets. As incomes rise, however, the share spent on food declines, while the share for housing remains relatively constant—and the shares for transportation and telecommunications grow rapidly. In all regions half of BoP household spending on health goes to pharmaceuticals. And in all except Eastern Europe the lower income segments of the BoP depend mainly on firewood as a cooking fuel, the higher segments on propane or other modern fuels.

A BoP portrait

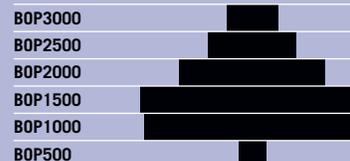
THE DEVELOPMENT COMMUNITY has tended to focus on meeting the needs of the poorest of the poor—the 1 billion people with incomes below \$1 a day in local purchasing power. But a much larger segment of the low income population—the 4 billion people of the BoP, all with incomes well below any Western poverty line—both deserves attention and is the appropriate focus of a market-oriented approach.

The starting point for this argument is not the BoP's poverty. Instead, it is the fact that BoP population segments for the most part are not integrated into the global market economy and do not benefit from it. They also share other characteristics:

Addressing the unmet needs of the BoP is essential to raising welfare, productivity, and income—to enabling BoP households to find their own route out of poverty. Engaging the

REGIONAL PROFILES

BoP MARKET BY INCOME SEGMENT ASIA
\$3,470 billion



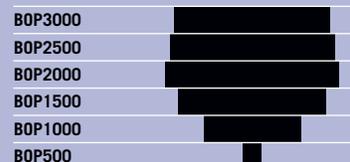
Asia (including the Middle East) has by far the largest BoP market: 2.86 billion people with income of \$3.47 trillion. This BoP market represents 83% of the region's population and 42% of the purchasing power—a significant share of Asia's rapidly growing consumer market.

EASTERN EUROPE
\$458 billion



Eastern Europe's \$458 billion BoP market includes 254 million people, 64% of the region's population, with 36% of the income.

LATIN AMERICA & THE CARIBBEAN
\$509 billion



In Latin America the BoP market of \$509 billion includes 360 million people, representing 70% of the region's population but only 28% of total household income, a smaller share than in other developing regions.

AFRICA
\$429 billion



Africa has a slightly smaller BoP market, at \$429 billion. But the BoP is by far the region's dominant consumer market, with 71% of purchasing power. It includes 486 million people—95% of the surveyed population.

BoP in the formal economy must be a critical part of any wealth-generating and inclusive growth strategy. And eliminating BoP penalties will increase effective income for the BoP. Moreover, to the extent that unmet needs, informality traps, and BoP penalties arise from inefficient or monopolistic markets or lack of attention and investment, addressing these barriers may also create significant market opportunities for businesses.

Perhaps most important, it is the entire BoP and not just the very poor who constitute the low-income market—and it is the entire market that must be analyzed and addressed for private sector strategies to be effective, even if there are segments of that market for which market-based solutions are not available or not sufficient.

Characterizing BoP markets

TOTAL ANNUAL household income of \$5 trillion a year establishes the BoP as a potentially important global market. Within that market are significant regional and national variations in size, population structure income distribution, and other characteristics.

Spending patterns

POPULATION structure by itself is not a reliable guide to market composition. Accordingly, this analysis also examines BoP

spending patterns by country, sector, and income level. This analysis is based on a World Bank initiative—the International Comparison Program—to standardize the expenditures reported by national household surveys into defined categories.

BoP characterized by sector markets

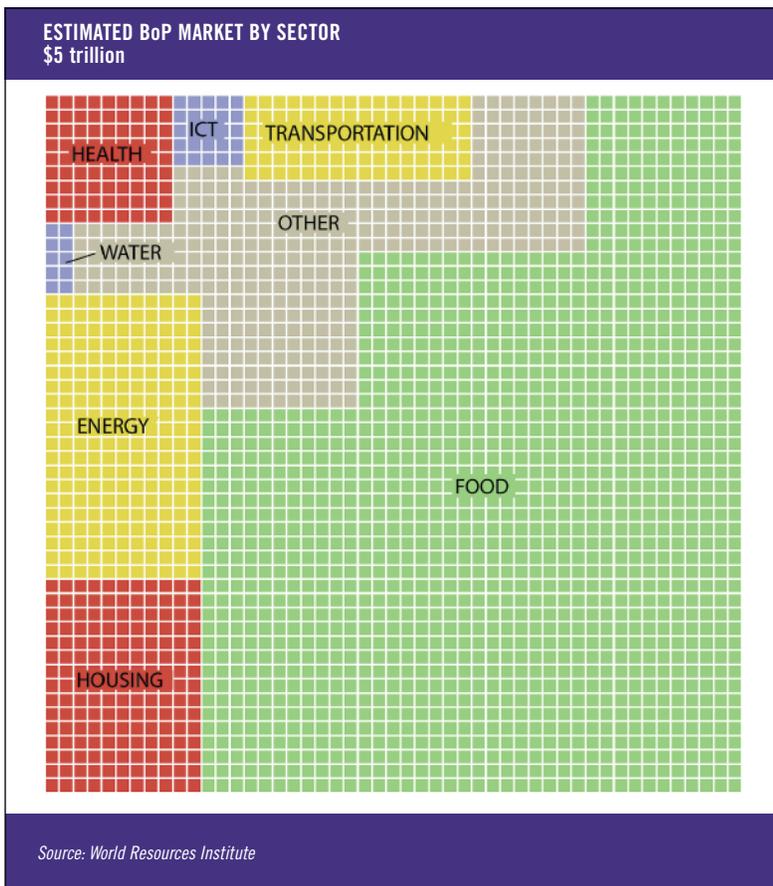
SECTOR MARKETS for the 4 billion BoP consumers range widely in size. Some are relatively small, such as water (\$20 billion) and information and communication technology (ICT) (\$51 billion as measured, but probably twice that now as a result of rapid growth). Some are medium scale, such as health (\$158 billion), transportation (\$179 billion), housing (\$332 billion), and energy (\$433 billion). And some are truly large, such as food (\$2,895 billion).³

Evidence of BoP penalties emerges in several sectors. Wealthier mid-market households are seven times as likely as BoP households to have access to piped water. Some 24 percent of BoP households lack access to electricity, while only 1 percent of mid-market households do. Rural BoP households have significantly lower ICT spending and are significantly less likely to own a phone than rural mid-market households or even urban BoP households—consistent with the broad lack of access to ICT services in rural areas.

BoP market analysis

A KEY ISSUE IN UNDERSTANDING BoP markets is informality. The International Labour Organization estimates that more than 70 percent of the workforce in developing countries operates in the informal or underground economy, suggesting that most BoP livelihoods come from self-employment or from work in enterprises that are not legally organized businesses. This informal economy is a significant fraction of the size of the formal economy. According to a detailed study by economist Friedrich Schneider,⁴ the informal economy averages 30 percent of official GDP in Asia, 40 percent in Eastern Europe, and 43 percent in both Africa and Latin America and the Caribbean. Informality is a trap for the assets and the growth potential of micro and small businesses and those who work in them.

These results together suggest that a significant part of BoP income comes from activities and sources that are only indirectly reflected in national economic statistics. Household surveys, in contrast, usually seek to capture all sources of income or total expenditures. Reporting of income may not be precise, but in this report the



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A local company, Azmetco, was awarded a contract by BP to check and test various types of meters.

and numerous other companies in Azerbaijan. Currently Debet Uniform employs 117 people.

The development of Debet Uniform was possible through the supplier development project launched in 2004 and implemented in partnership with German Technical Cooperation (GTZ), the Enterprise Centre, and IFC. GTZ was contracted specifically to provide an experienced specialist—a mentor—that could provide the technical and business training and advisory services that were needed. A gap analysis of Debet was conducted which showed where the key areas that needed improvement were. Since 2006 this project has been funded by BP's Regional Development Initiative (RDI), a long term socio-economic development program funded by BP and its co-venturers in major oil and gas projects in Azerbaijan.

In 2007, BP awarded a \$6 million, 3-year contract to Debet Uniform Ltd for the supply of personal protective equipment in Azerbaijan and Georgia. A key condition for Debet to be able to fulfil this contract was to obtain medium/long-term financing. Debet Uniform received a loan from the Suppliers Finance Facility, using its contract with BP as collateral, and with a term of 3 years, equal to the term of the BP supply contract. Debet's work, which was previously performed by a foreign firm, was an example and signal to the market place that with proper support and assistance, local companies could compete and win in the international market place!

Due to rapidly increasing oil exports and the high oil price, Azerbaijan's economy grew at an amazing rate of 34 percent in 2007. BP and IFC's assistance will help ensure that small businesses can also participate, develop and benefit from this growth.

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income data are buttressed by detailed, standardized expenditure data in a substantial subset of countries.

A new way of thinking about poverty reduction

THE BOP MARKET ANALYSIS in this study is intended to help businesses and governments think more creatively about new products and services that meet BoP needs and about opportunities for market-based solutions to achieve them. For businesses, characterizing the market in empirical terms is an important first step toward identifying business opportunities, considering business models, developing products, and expanding investment in BoP markets. Put simply, while an analysis of the depth of poverty does not generate private sector enthusiasm for investment, an analysis of BoP market size and willingness to pay might—and is thus a critical step toward market-based solutions. For governments, such an analysis can help focus attention on reforms needed in the operating and regulatory environment to allow a larger role for the private sector.

The market-based approach to poverty reduction and empirical market data described in this report are equally important for the development community. They can help frame the debate on poverty reduction more in terms of enabling opportunity and less in terms of aid. A successful market-based approach would bring significant new private sector resources into play, allowing development assistance to be more sharply targeted to the segments and sectors for which no viable market solutions can presently be found. Market-based approaches and smart development policies are synergistic strategies.

Perhaps most important, a market-oriented approach recognizes that only sustainable solutions can scale to meet the needs of 4 billion people.

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Endnotes

¹ In this study, current U.S. dollars means 2005 dollars. Unless otherwise noted, however, market information is given in 2005 international dollars (adjusted for purchasing power parity); for convenience, BoP and mid-market income cutoffs are given in international dollars for 2002 (the base year to which household surveys used in the analysis for the report have been normalized). U.S. dollars are generally denoted by US\$, international dollars by \$.

² World Resources Institute, World Bank, United Nations Development Programme, and United Nations Environment Programme, *World Resources Report: The Wealth of the Poor*, 2005, Washington DC.

³ International Labour Organisation, *Key Indicators of the Labour Market*, 2nd ed., 2002. Geneva: ILO.

⁴ Frederich Schneider, "Size and Measurement of the Informal Economy in 110 Countries around the World" Working Paper 2005-13, Center for Research in Economics, Management and the Arts, Johannes Kepler University of Linz.