Dynamic Capabilities and the Bottom of the Pyramid: Exploring Firm Requirements

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Management Summary

The current research has investigated what company requirements for successful engagement in the Bottom of the Pyramid\(^1\) can to what extent be gained from the Dynamic Capability\(^2\) Perspective. In order to provide a solid answer to this question both the DC perspective and the BoP concept literature has been discussed. In short, the BoP refers to a concept that allows firms to successfully invest in subsistence markets, whereas the DC provides both a perspective and the means to survive dynamic markets.

In the synthesis of these two phenomena it appeared that the overlap was in the market, the transformation dominant logic, collaboration with (numerous) other parties, importance of learning, transformation/creation business model, co-creation/co-evolving and learning DC to the BoP. Furthermore, it was found that successful BoP engagement can be interpreted as being the most radical form of being Dynamically Capable. Therefore, the DC requirements found from literature should be interpreted in its most radical form in order to develop sound firm requirements for BoP engagement.

Consequently, a radically dynamically interpreted list of DC requirements for the BoP participants was distilled from literature. One can conclude from this list that potential BoP engaging MNC, and moreover its team that is going to enter the BoP, should be capable of eliminating all limitations to learning and create the total learning organization from the bottom up. Example requirements are forgetting previous company existence of position, processes and path; being radically explorative and optimizing learning antecedents\(^3\).

This total learning organization is an exceptional kind of organization because many organizations face organizational learning barriers that limit total learning. Therefore, the found firm requirements drastically reduce the potential amount of successful BoP participants, because many companies will not be able to have or create this total learning organization. As the Total Learning Organization is an exceptional demand for companies, this requirement can also be interpreted as a demand for the BoP team of the firm: the team should namely be radically Dynamically Capable for competently dealing with the BoP and the company itself should be able to support them in a Dynamically Capable fashion.

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1 From now on named: ‘BoP’
2 From now on named: ‘DC’
3 Actual list of company requirements gained from DC literature can be found on page 28
Preface

“Let the light at the Top of the Pyramid be used to illuminate the hidden opportunities at the ‘dark’ Bottom of the Pyramid” (Front page interpretation)

Still amazed by Stuart Hart’s book “Capitalism at the Crossroads” I decided to write my thesis about the Bottom of the Pyramid. This truly brilliant body of thought inspires companies to do both good and well at the same time in the world’s subsistence markets (both making good profit whilst doing well ‘for the world’). With this interest I furthermore joined prof. dr. Geurts’ exciting quest for the construction of an organizational learning game for this Bottom of the Pyramid concept. This game should prepare BoP interested companies for their adventure in the subsistence markets.

However, when gradually increasing my knowledge about the BoP concept my skepticism about the companies that are able to be successful BoP engagers grew proportionally. The challenges posed by the BoP concept seemed to be unequaled by contemporary company demands in Western markets. Yet, I still believed in the possibility of successful BoP engagement for more companies than that are currently ‘BoP’ing’, so it was time to find ways to help Western businesses in their BoP engagement in some way.

The only way I can strengthen the BoP concept is by reviewing literature and hence investigate what companies should play our game. To get a better insight on this case, it was necessary to seek separate, yet complementary literature in order to examine the type of firms that can enter the BoP market. After an analysis on the possible domains to write my thesis in, I found the phenomenon of Dynamic Capabilities and yes, after getting a preliminary insight on Dynamic Capabilities I indeed found it to be the literature I was looking for. DC namely provided an insight how companies survive dynamical markets of which I assumed the BoP market definitely is one.

The answer to this would also be useful in the game that I have just mentioned. So in a way, I suppose that this thesis can contribute its knowledge to companies that are to play this game, as well as it can provide literature and other managerial benefits. Additionally, I hope that reading the current thesis is as pleasant as writing it, because I sincerely enjoyed working on this thesis.

Finally, I would like to thank prof. dr. Geurts both for aligning me with the BoP concept and providing me with the possibility to join the creation of this BoP game. I would also like to thank him for the initial feedback he gave me on my proposal. In addition I would like to thank dr. Groen for her feedback, as well as I would like to thank my co-reader group and Rutger Soffers for their feedback.
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Chapter 1: Introduction

1.1: Opening

The Fortune at the Bottom of the Pyramid

In the article “The Fortune at the Bottom of the Pyramid” Hart and Prahalad (2002a) reveal a world of opportunities in the BoP the world of the poorest people. C.K. Prahalad and S.L. Hart have developed a concept that ultimately allows businesses to gain profits in the underdeveloped world, and moreover create a more sustainable, more prosperous world for all parties involved.

However, and this seems an enormous however, it is tremendously difficult for Western companies to utilize the BoP concept, for there are inherent challenges that seem to contradict Western way of doing business (Prahalad, 2009, p. 32).

Nevertheless, the Western world does provide academic literature with (indirect) respect to these challenges, namely the phenomena of innovation and DC (Teece, Pisano & Shuen, 1997). It will be explored to what extent the DC perspective provides useful insights for dealing with the BoP challenges. More importantly, this perspective can provide answers to what kind of company could be successful at engaging in the BoP.

The BoP literature lacks specific company requirements for engaging in the BoP. Also, the DC literature has not yet made a clear connection between DC and the BoP, because it this connection is merely assumed or partially constructed. Whereas most DC literature focuses on high technology and emerging markets, the BoP can be an enrichment of the DC literature.

The academic relevance of this thesis is constituted by the synthesis, created by the complementary enrichment of these two abstract phenomena, which is thus not adequately created yet. The managerial relevance is constituted by the provision of the requirements of potential BoP participants that can either recommend or discourage BoP engagement.

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4 Vermeulen, Bertisen and Geurts (2008) have assumed the connection between DC and the BoP, without figuring out what the similarities are. Tashman & Marano (2010) have partially constructed a connection.
1.2: Structure of the Thesis

Most importantly, the research question of the current thesis will be the following:

*What Company Requirements for Successful Engagement in the BoP can to what extent be gained from the DC Perspective?*

In short, this thesis will firstly elaborate on the two phenomena of DC and BoP and hence makes a clear connection between the two phenomena. Ultimately from the found literature the firm requirements (gained from this connection) can be distilled. Therefore this thesis will be divided in the following segments:

1.2.1: Chapter 2: Elaboration on the DC perspective

- **General Introduction**
  - What is the definition of DC, what encompasses DC?
- **Market Conditions**
  - In what markets are DC important?
- **Creation and Development DC: Learning**
  - According to DC literature, DC can be created and further developed by learning mechanisms. Additionally, this learning of DC has certain antecedents that will also be discussed in this section.
- **The Continuum of DC**
  - In this section Schreyögg and Kliesch-Eberl (2007) is used in order to sketch a continuum the different levels of DC. In other words: when are DC to what extent important?

1.2.2: Chapter 3: Elaboration on the BoP

- **General Introduction**
  - What actually is the BoP Concept?
- **BoP Participants**
  - What companies are presently put forward by the BoP literature to engage in the BoP?
- **BoP Challenges**
  - What challenges does the BoP concept pose on the BoP participants? This section is split up in the four critical success factors for BoP engagement, found by London and Hart (2004).
1.2.3: Chapter 4: The connection between DC and the BoP

Now that both phenomena have extensively been discussed, it is possible to investigate to what extent the two concepts can be united. The vital question here is: to what extent can the challenges of the BoP be answered by the insight gained from the DC perspective? Both concepts will be analyzed on their similarities and complementarities.

1.2.4: Chapter 5, Conclusion: Implications for Firm requirements

Finally, it is possible to extract the firm requirements from the previous chapters. The BoP already has some requirements, but mainly due to the synthesis between the BoP and the DC perspective several more requirements can be found. Consequently, elaboration will follow on which DC requirements and to what extent these firm requirements hold for successful BoP engagement.

Hence, the focus of this thesis lies on making this connection and distilling the company requirements, rather than criticizing both phenomena\(^5\). As both phenomena are rather abstract there has been much debate about what the two phenomena actually are and what constitutes them. Therefore, this thesis integrates literature of both concepts that show most overlap, instead of committing full research on all advantages and disadvantages of every interpretation of these phenomena, because this way the answer to the research question cannot be provided.

1.3: Research methods

1.3.1: Type

The type of research design will be an exploratory one, for the relation between these two phenomena will be investigated. The method used for this is a literature research.

1.3.2: Key Concepts & Their Factors

- **BoP Concept**
  - Challenges, Innovation, Co-creation, Subsistence markets, inter-organizational collaboration, Marketing in subsistence markets.

- **Dynamical Capabilities**
  - Sensing, Seizing, Reconfiguring, Ambidexterity, Organizational Learning, Inertia, DC markets, International DC, Collaborative DC.

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\(^5\) E.g. Wilson & Wilson (2006) for the BoP and Barreto (2010) for DC with all the different definitions of DC
1.3.3: Data Collection

This literature research will rely on secondary sources: articles gained from scientific journals and scientific books. The articles will be found through scientific search engines as Web of Science. Initially Web of Science will be used to find literature, for this database has a good search engine and is able to sort articles on ‘times cited’ which has numerous advantages. The necessary articles can also be found by considering ‘related articles’ in the databases, or by looking in the references of the useful papers. One can look at the references used by an author, or by looking at the authors that have cited the first author. In addition, the journal impact factor will be taken into account in order to value the credibility and impact of an article. Finally, the eminent books concerning the BoP concept of Hart and Prahalad are in possession.
Chapter 2: Dynamic Capabilities

“It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is the most adaptable to change.” (Charles Darwin)

2.1: General Introduction

So the thesis starts off by reviewing a perspective in which the current research can be positioned. In essence, DC have been posed as a perspective that tries to explain sustainable competitive advantage. The DC perspective distinguishes itself by focusing on how competitive advantage can be sustained by the continuous development of new capabilities (Teece et al., 1997). Their definition of DC is as follows: “the firm’s ability to integrate, build, and reconfigure internal and external competencies to address rapidly changing environments.” Teece, (2007) later specifically defined these capabilities as Sensing, Seizing and Reconfiguring capabilities. In his view Dynamically Capable firms have sensing capabilities that stimulate scanning, creation, learning, and market interpretation activities. Hence, these firms strategize the business model and investment decisions and create understanding of organizational change when an opportunity is found (seizing). Subsequently they recombine and reconfigure assets and organizational structures as the enterprise grows in order to minimize constraints that limit the seizing options of successive opportunities (reconfiguration). Zollo and Winter (2002) insert that some routines are learned naturally, but consciously developing adapting routines are DC. Eisenhardt and Martin (2000) note that DC are constituted by knowledge creation, collaboration, ample communication, cross-functional relationships, co-evolving products and rapid learning. Furthermore, they note that flexibility in the organization and product development process (by e.g. prototyping and partial implementation) are DC. Moreover, most researches that learning is a vital aspect of the creation and development of DC (e.g. Luo, 2000; Cepeda & Vera, 2007), because DC cannot be bought: they must be built (Teece, et al., 1997), which will be discussed shortly hereafter.

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6 So in essence it is similar to the perspectives as the five forces of Porter, the strategic conflict approach and the resource based view (Teece et al., 1997)
7 Sometimes called ‘routines to learn new routines’ (Teece et al., 1997), ‘higher order capabilities’ (higher than regular processes) (Barreto, 2010; originally from Winter, 2003), or ‘evolutionary capabilities’ (in contrast to technical capabilities, that refer to regular processes) (Teece, 2007)
8 It should be noted that much of the literature (e.g. Cepeda & Vera, 2007; Prieto, Revilla & Rodriguez-Prado, 2009) DC are about technological markets (because those are rapidly changing). However, DC literature also expands to other markets (e.g. Luo, 2000; Eisenhardt & Martin, 2000; Teece, 2007; Zhou & Li (2010))
9 For a more elaborate discussion about the sensing, seizing and reconfiguring DC of Teece (2007) please read Appendix A
10 Eisenhardt and Martin (2000) refer to both internal and external parties when naming cross-functional teams, collaboration, co-evolving and communication
2.2: Market Conditions

The importance of addressing the environment is a vital part of DC, because originally DC were introduced for rapidly changing environments (Teece et al., 1997). At present however, DC can also be used in moderately and stable environments (Barreto, 2010)\(^{11}\) or in underdeveloped markets (Teece, 2007)\(^{12}\). The essence of DC is the need to learn and adapt to the environment and the magnitude of this need is dependent on the environment (Eisenhardt & Martin, 2000). Hence, the more dynamic the environment, the higher is the need for DC. Eisenhardt and Martin (2000) and Luo (2000) have characterized the extremely dynamic markets (or what Luo names hostile foreign environments) for DC, please observe the figure below for an overview.

![Eisenhardt & Martin (2000)](image1)

**Figure 1: Eisenhardt & Martin’s extremely dynamic markets and Luo’s hostile foreign environments**

Furthermore, Zhou and Li (2010) have also stressed the importance of DC in emerging economies, and add that the adaptive capability in these foreign markets is the most important DC. Eisenhardt and Martin (2000) add to this that in these markets firms cannot rely on existing knowledge, and it can even become disadvantageous (because it can discourage learning). Effective DC are therefore simple routines, because the management should focus on broadly important issues and so there should be only some boundary conditions.

2.3: Creation and Development DC: Learning

As stated in the introduction, learning is vital for the creation and development of DC. Learning thus plays a double role: it is both the antecedent (Zollo & Winter, 2002) as well as it guides the development

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\(^{11}\) A nearly redundant note, because it is logical that every company always is in need of adaptive skills to some extent

\(^{12}\) This proves to be an important link to the BoP, as will be discussed later
of them (e.g. Teece, 2007). Learning is necessary to create sensing capabilities, and later to use learning to grasp opportunities (learning and unlearning routines) and remaining Dynamically Capable.

So the question becomes: how can a company create DC? Zollo and Winter (2002) provide an interesting three step procedure for which they propose that DC emerge from the co-evolution of tacit knowledge accumulation processes, explicit knowledge articulation and codifying activities.

<table>
<thead>
<tr>
<th>Experience accumulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central learning processes that go beyond normal routine development; companies should invoke mechanisms that go beyond the creation of tacit knowledge development. In other words: personnel should be exposed to (new) experience (more intensely or more frequent), good performance monitoring systems should be present, and sufficiently powerful incentives to ensure that individuals will initiate the search routines when performance levels decay</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Knowledge articulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Implicit knowledge articulation: becoming more aware of the overall performance implications of organizational actions and knowledge that is directed at enhancing organizational understanding through collective discussion, debriefings and performance evaluations. Collective learning expressing opinions and beliefs, engage in constructive confrontations and challenging each other. This understanding results in adaptive adjustments to the existing set of routines or it enhances the recognition of the need for more fundamental change</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Codification process</th>
</tr>
</thead>
<tbody>
<tr>
<td>After the knowledge is articulated it should be codified (in e.g. manuals, decision support systems), so that it can subsequently be diffused through the organization. Developing and transferring know why as well as knowhow is vital</td>
</tr>
</tbody>
</table>

Figure 2: Zollo and Winter’s procedure for the DC creation

In other words, firms need to learn systematic ways to shape their routines by adopting an opportune mix of the above mentioned in order to create DC\textsuperscript{13}, whereas this mix itself also is a DC\textsuperscript{14}. The effectiveness of learning DC is bounded to certain firm characteristics. Several authors have researched these and these have been synthesized in the table below.

\textsuperscript{13} A substantial amount of literature concerns the learning of DC. A couple of writers support what Eisenhardt and Martin (2000) find (e.g. Weerawardena et al., 2007) but others have named these three phases slightly different (although the actual content mostly refers to the same thing); Luo (2000) finds: knowledge acquisition, knowledge sharing and knowledge utilization. In addition Prieto, Revilla, Prado (2009) find knowledge generation, knowledge integration and knowledge reconfiguration

\textsuperscript{14} Hence the auto-causality of DC, which is one of the ambiguities of the DC phenomenon
Firstly, Zollo and Winter (2002) have found contingencies to organizational learning of DC. The effectiveness of learning DC is contingent to Organizational Features (openness to change), Environmental Conditions (turbulence) and Task Features. It can be stated that the higher the openness to change is, the more turbulent the environment is and the higher the economic importance, frequency, degree of heterogeneity and the higher the degree of causal ambiguity in action-performance links, the more effective learning is. In addition, Prieto, Revilla and Rodriguez-Prado (2009) have found several contextual contingencies to organizational learning of DC. The better the performance management, the more autonomy, trust and support, the higher is the effectiveness of learning. Finally, Luo (2000) found the necessary corporate infrastructure (and the necessary commitment) for effective learning of DC.

Furthermore, several authors emphasize on learning and DC when considering international markets. Luo (2000) notes that DC in foreign markets should stimulate the learning and internalization of new concepts, cultures and new markets. He adds that when knowledge increases, the firm’s vulnerability decreases. Weerawardena, Mort, Liesch and Knight (2007) have specifically found four DC important for accelerated internationalization for the born global firm. These are market learning, internally focused...

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15 They hereby refer to a collaborative context where people can think and work together by exchanging building should be present in the organization.

16 The more important change is, the higher the learning effectiveness.

17 Teece, Pisano and Shuen (1997) add to this that autonomy is accompanied by decentralization.

18 It should be noted that in Prieto et al. (2009) surprisingly found trust insignificant in their research, while they note that in many research this has been found significant. Trust is included in this research, since the current context is different (not Spanish R&D firms), because trust is essential in the BoP (as will appear later).

19 E.g., speed of technological environmental change.

20 Which is interesting for the current research setting since engaging in BoP would mean internationalization and in some way the company that is going to be established is born globally since it is a form of a spin off from a MNC.
learning, networking capabilities (learning and identifying opportunities via a network) and marketing capabilities. By stressing these capabilities they emphasize on the importance of learning in new and international markets.

If one synthesizes the previous literature, one would view the sequential figure below. The antecedents of effectively learning DC are followed up by the actual learning process that results in the actual DC.

![Figure 3: Synthesis previous literature on DC: antecedents to learning, learning and DC themselves](image)

### 2.4: The Continuum

Now that the literature of both DC and the antecedents of DC have been discussed, it is imperative to create transparency on the various levels of DC. Schreyögg and Kliesch-Eberl (2007) have found three levels of Dynamization approaches to DC, which can be found below.

#### 2.4.1: Radical Dynamization Approach

According to Schreyögg and Kliesch-Eberl (2007) this is the most dynamical approach and refers to full blown adaptability. It is about mastering volatility by creating the ‘total learning organization’. This approach is said to be most adaptable, but it lacks possibilities to exploit the market because of the high
need to change and adapt all the time (it is assumed that in this approach companies *always* change and hence cannot let an organization grow).

### 2.4.2: Integrative Dynamization Approach

This approach is more static than the previous one, because it takes the contingencies to DC into account. Due to these contingencies the (radical) adaptability is restricted to the extent that these contingencies are present. Schreyögg and Kliesch-Eberl (2007) refer to Teece et al.’s (1997) firm *position, processes and paths*. By *position* they refer to the firm’s current specific endowments of technology, intellectual property, complementary assets, customer base and its external relations with suppliers and complementors. By *processes* they refer to routines or patterns of current practice and learning and by *paths* they mean strategic alternatives of the firm (on the current path dependency)\(^{21}\). In short, the integrative includes learning, reconfiguring and transforming capabilities while taking account of the static processes. DC are added to the normal processes instead of being the core of the firm.

### 2.4.3: Routinized Dynamization Approach

Finally, there is the innovation routines approach which is the most static of the previous approaches. The company invokes separate innovation routines that are external to the core processes of the company. The goal of these routines is overcoming the risk of being trapped in an inertial path dependency (lock-in) by investigating both internal (e.g. improving productivity) as external opportunities.

Schreyögg and Kliesch-Eberl (2007) criticized these approaches mainly because of the tradeoffs found in explorative and

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\(^{21}\) For example, if a company has a certain history which has reduced alternative opportunities/paths (path dependency) a company is less Dynamically Capable (because if it would reconfigure, the company would fail).
exploitative behaviour: “to stress one dimension necessarily means negating the other”\textsuperscript{22}. Later, in 2008, O’Reilly and Tushman (2008) added ambidexterity as a DC, which essentially refers to the capability of balancing explorative and exploitative according to the market demand. So according to O’Reilly and Tushman (2008) the extent to which the balance leans towards exploitative or explorative behaviour depends on whether the market demands change from the organization. Hence, if the environment is dynamic, a firm should engage more in explorative rather than exploitative behaviour.

\subsection*{2.4.4: Organizational Inertia}

In order to complete the continuum it is important to also take notion of organizational inertia, because this would be the anti-DC, which will hence be placed on the extreme left of the continuum. This organizational inertia is originally defined as “limitations on the ability to adapt” (Hannan & Freeman, 1977), and more specifically as “the organizational tendency to resist change and resist the ability of organizations to innovate and reconfigure their internal resources” (Larsen & Lomi, 2002).

So the continuum which has been discussed looks as figure 4 presents.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{continuum.png}
\caption{The continuum on the different levels of DC}
\end{figure}

\subsection*{2.5: Chapter Conclusions}

It has been discussed that DC are a perspective as well as the means to adapt to the environment. Sensing, seizing and reconfiguring are the actual DC. Additionally, DC can be applied in different markets, in which the turbulence of that market determines the magnitude of the need of DC. Moreover, it has been discussed how to create and develop DC by learning (and its antecedents). Finally, a continuum of the various Dynamization levels of DC has been constructed.

\textsuperscript{22} When a firm mostly engages in explorative behaviour (initiating innovations: constantly finding new opportunities and hence create a willingness to adapt) consequently means that a firm can invest less in exploitative behaviour (executing innovations) and vice versa.
Chapter 3: BoP Concept

3.1: General Introduction

The second phenomenon that will be reviewed is the BoP\textsuperscript{23} concept. The concept begins with the finding that the largest group of people roaming this earth has been neglected by the private sector (Prahalad & Hart, 2002a). When one views the world’s population in income rates one sees the pyramid of figure 5 (Prahalad & Hart, 2002a). The BoP concept is originally introduced to draw attention to the 4-5 billion poor who are unserved or underserved by the large organized private sector, including multinational corporations (Prahalad, 2009, p. 6)\textsuperscript{24}. Still, the BoP accounts for 5 trillion in purchasing parity terms (Prahalad, 2009, p. 7)\textsuperscript{25}. According to Prahalad (2009, p. 8), the fourth tier presents the engine for the next round of global trade and prosperity and provides huge opportunities and challenges (Hart, 2007, p. 114). To grasp the original concept in short: “the poorest populations raise a prodigious new managerial challenge for the world’s wealthiest companies: selling to the poor and helping them improve their lives by producing and distributing products and services in culturally sensitive, environmentally sustainable and economically profitable ways” (Prahalad & Hart, 2002a). So, the BoP concept should result in a more sustainable and more prosperous world for all parties (Prahalad, 2009, pp. 6-8). When regarding the BoP literature one will derive that the essence of effectively reaching the BoP lies in the co-creation and creation of mutual value and not just selling the poor (Viswanathan, Seth, Gau & Chaturvedi, 2009) While the BoP concept is still gaining momentum (London, Anupindi & Sheth, 2009), it has also received some criticism\textsuperscript{26} (e.g. London et al., 2009; Wilson & Wilson, 2006, p. 29;}

\textsuperscript{23} Recap: Bottom of the Pyramid
\textsuperscript{24} There is a discussion about what actually represents the Bottom of the Pyramid, e.g. the bottom billion, the next four billion, the next billion (Prahalad, 2009)? This report will define the BoP as the next four billion of underserved or unserved poor.
\textsuperscript{26} The lion’s share of the criticism is: the concept is based on insufficient empirical research and the excessive risk the BoP concept poses makes the BoP concept unattractive. The criticism on the BoP concept will not be the focus of the current report.
Firstly the focal firms for BoP engagement will be discussed, followed by the challenges of the BoP concept for Western companies.

### 3.2: BoP Participants

According to Prahalad and Hart (2002a) multinational corporations\(^{28}\) are put forward to engage in the BoP. MNC are the only entities that have the technology, sources, capacity and global reach so that they can successfully engage in the BoP (Hart, 2007, p. 3). Furthermore, Hart (2007, pp. 162-163) distinguishes four reasons why MNC are the most advantageous focus group, which are presented in the figure below.

![Figure 3: Reasons why MNC is the focal group for BoP engagement](image)

In addition, Prahalad (2009, p. 30) states that MNC should shift from BoP engagement for the sake of corporate social responsibility to making BoP part of their core business in order to be successful.

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\(^{27}\) From Hart (2007, p. 107)
\(^{28}\) Still named ‘MNC’
3.3: Challenges

“It’s like the story of the person who finds a $20 bill on the sidewalk; conventional economic wisdom suggests that if the bill really existed, someone would have already picked it up”

(Prahalad & Hart, 2002a)

This quote nicely shows that there are no risk-free gains. This is a fortiori true for the BoP concept, because successful BoP engagement remains a great challenge for Western companies Hart (2007, pp. 120-121). Nevertheless, there are ways to obtain successful BoP engagement, which will be discussed in the current section. London and Hart (2004) found four Critical Success Factors (CSFs) for successful BoP engagements, and these will provide the framework for this section. The challenges are:

- Developing Social Embeddedness;
- Co-inventing Custom Solutions: Building Bottom-up;
- Collaborating with Non-Traditional Partners;
- Developing Local Capacity: Sharing Resources Across Boundaries.

Also, it is essential that the dominant logic of MNC is discussed, which will follow after the CSFs.

3.3.1: CSF 1: Developing Social Embeddedness

This capability refers to developing a deep understanding of the local environment by identifying, leveraging and building the existing social infrastructure (London & Hart, 2004).

Academic literature finds that BoP markets have an exceedingly social nature: whilst being resource poor, they are network rich (Viswanathan & Rosa, 2009). They add that the social network cuts across families and communities and allows fluid information exchange, which allows the consequential learning and the development of consumer ‘skills’ (Viswanathan, Sridharan & Ritchie, 2009b). Due to the illiteracy in these markets social networks 1 to 1 interactional markets should be harnessed by the MNC (Weidner et al., 2009), so word of mouth is extremely important.

In addition, Rivera-Santos and Rufin (2010) find that the MNC should use the present social (informal) infrastructure for the BoP engagement, since the informal and interpersonal system is more stable and

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29 One should bear in mind that these CSFs share overlap
resilient than the formal one. These ties should be enhanced by increasing trustworthiness, credibility and fairness through focusing on local embeddedness and the creation of communitywide welfare (Viswanathan et al., 2009a).

Moreover, Prahalad (2009, pp. 15-16) stresses the value of this network by stating that the MNC should act as the nodal firm between all the self-regulating systems (of e.g. micro-entrepreneurs, consumers, other non-traditional partners) in the business model, because this is the only way scalability is created (which in the end is necessary for a profitable BoP engagement).

To conclude, it is vital that a BoP engaging MNC should be highly socially embedded in order to be successful (Rivera-Santos & Rufin, 2010).

3.3.2: CSF 2: Co-inventing Custom Solutions: Building Bottom-up

Perhaps the most vital and most discussed ingredient to successful BoP engagement: co-creation. London and Hart (2004) state that entering the BoP requires a global capability beyond the adaptive skills of national responsiveness; MNC should listen deeply to the poor and co-design, co-develop and co-create with them.

More specifically, it starts with researching and trying to understand subsistence marketplaces (Weidner et al., 2009) and life circumstances (Viswanathan et al., 2009a). Prahalad (2009, pp. 13-15) notes that accessing local knowledge, expertise, and learning about the needs are enhanced when the firms integrative and collaborative capabilities are higher, because this learning will be bottom up (Viswanathan & Rosa, 2009). Through this understanding the needs and the affordable prices of the poor can be identified (Weidner et al., 2009).

After the initial non-commercial learning engagement it is time to design the (communitywide) value proposition and hence to co-create products/services (Hart, 2007, p. 196). In both understanding and co-creating the MNC must provide mutual benefits as e.g. partial ownership for the participating entrepreneurs (London & Hart, 2004). As the fulfillments of the needs are new and complicated (e.g. very low prices) the entire business process needs to be reconfigured (Prahalad & Hart, 2002a). The companies should however have some guiding constraints for this co-created services or products (Prahalad, 2009, pp. 11-18), which are presented in the figure beneath.

According to Prahalad and Hart (2002a) this means dramatically reducing cost levels to approximately 10% of what they are today at the Top of the Pyramid, so that the BoP can afford the products and services.

3.3.3: CSF 3: Collaborating with Non-Traditional Partners

Derived from the results of London and Hart (2004) the significance of collaboration with non-traditional partners in order to gain the missing resources and expertise is great, because MNC insight in the developing country’s culture and local knowledge is diminutive (Prahalad & Hart, 2002a). London and Rondinelli (2003) therefore note that MNC must overcome cross-organizational barriers to convene a diversity of stakeholders and create relationships with non-traditional partners. Regarding the MNC’s resources, reputation, and convening power they can attract the necessary range of potential partners (London & Hart, 2004). These partnerships enable MNC to better understand the social context of an environment that is local, diverse, dynamic, complex and unpredictable. Prahalad & Hart (2002a) state that these partners can be local firms/cooperatives, governments and local or international NGO’s. Hart (2007, p. 178) notes that even ‘fringe stakeholders’\(^{31}\) should be included in the business processes.

On the other hand, including non-traditional partner enhances trust of BoP consumers, because they often have limited (or unpleasant) experiences with formally based businesses (London et al., 2009). They furthermore state that these relationships are crucial to the venture’s long term viability as they often provide an ongoing source of legitimacy and additionally offer a conduit for effectively and efficiently addressing constraints faced by BoP consumers and so they can generate appropriate amounts and types of local value.\(^{32}\)

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\(^{31}\) Every partner outside the regular stakeholder idea (regular is e.g. competitors and customers). Fringe stakeholders can be adversary, weak, illiterate, disinterested, isolated stakeholders.

\(^{32}\) It should be noted that this CSF bears quite some overlap with CSF 1. The difference however is that CSF 1 embodies the usage and leverage of the current social network (e.g. social relations), whereas CSF 2 refers to the actual collaboration with other institutions (also outside the BoP)
3.3.4: CSF 4: Developing Local Capacity: Sharing Resources Across Boundaries

Since the BoP markets have been largely ignored there is no or low consumer capacity in the BoP. Therefore companies must consider both societal performance and the sharing of resources outside firm boundaries (local capacity building) to be successful (London & Hart, 2004). In other words, the viable market ecosystem itself, including all the important stakeholders, is yet to be built (Prahalad, 2009, p. 13). Prahalad (2009, pp. 17-18) adds to this that this market development is a main challenge because new business models, constructed with local knowledge, are necessary to build new markets, and organizing the ‘unorganized’/extralegal markets.

Hart (2007, p. 145) states that these ‘unfreeoms’ posed by the poverty penalty and other constraints must be identified and removed by MNC. Hart (2007, p. 149) furthermore notes that providing consumer surplus through innovative products and services is important to increased earning power; saving the poor time and/or money frees up resources to be used more productively for other purposes or by generating income by the BoP engagement (Prahalad & Hart, 2002a).

3.3.5: MNC Dominant Logic

The target group of the BoP, the MNC, have several assumptions that guarantee resistance towards the utilization of the BoP concept (Prahalad, 2009, p. 32). Apparently, the BoP concept does not fit the dominant logic of contemporary MNC and therefore one of the first challenges would be to adapt the dominant logic to new markets (Prahalad, 2009, p. 54). Viswanathan and Sridharan (2009) state that this adaption refers to a philosophy of giving and taking and creating a mindset of mutual learning rather than viewing the BoP as a

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BoP Illustration

CEMEX is the third largest cement manufacturer in the world, operating in more than 50 countries. CEMEX established a savings and credit system to buy and store building materials so families could extend and improve their houses. The system allows families to build faster, cheaper and more efficiently. CEMEX also consults with the home owner on what material they should purchase, and how they should go about buying it. The company has recently developed ‘how-to’ workshops to teach basic construction skills.

Outcomes

- Between 1998 and 2006 served 140,000 families
- More than US$125 million in sales between 1998 and 2004
- Broke even in 2003 and in 2004 made a net profit of US$1.3 million (from membership fees)
- Expanding to Colombia, Venezuela, Nicaragua and the Philippines
- Goal to reach 1 million households by 2010

Excerpt from: Vermeulen et al. (2008)

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33 Tashman and Marano (2010) have already researched this element with respect to BoP and DC, so this section will discuss this CSF only shortly
34 For an elaborate discussion of the poverty penalty and the other constraints please view Appendix B: Developing Local Capacity: The Poverty Penalty
35 Another well known example is the provision of microcredit of e.g. the Yunnus bank. The lending of a few dollars can help breaking the vicious cycle of the poor by giving them an entrepreneurial opportunity (London & Hart, 2004)
plain market. This directly refers to the challenge that managers face, because for them, the real strategic challenge is to visualize an active market where only abject poverty exists today. In addition, managers should have creativity, imagination, tolerance for ambiguity, stamina, passion, empathy and courage, combined with analytical skill, intelligence and knowledge (Prahalad & Hart, 2002a).

<table>
<thead>
<tr>
<th>Assumption</th>
<th>Implication</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The poor are not our target customers; they cannot afford our products</td>
<td>• Our cost structure is a given, and with this structure we cannot serve the BoP</td>
</tr>
<tr>
<td>• The poor do not have use for products sold in developed countries</td>
<td>• We are committed to a form over functionality. The poor might need sanitation, but cannot afford the detergents in formats we offer. Therefore, there is no market in the BoP</td>
</tr>
<tr>
<td>• Only developed countries appreciate and pay for technological innovations</td>
<td>• The BoP does not need advanced technology solutions; they will not pay for them. Therefore, the BoP cannot be a source of innovations</td>
</tr>
<tr>
<td>• The BoP market is not critical for long term growth and vitality of MNC</td>
<td>• BoP markets are at best an attractive distraction</td>
</tr>
<tr>
<td>• Intellectual excitement is in developed markets; it is very hard to recruit managers for BoP markets</td>
<td>• We cannot assign our best people to work on market development in BoP markets</td>
</tr>
</tbody>
</table>

Figure 5: Dominant logic of MNC regarding the BoP

3.4: Chapter Conclusions

To conclude, the successful strategies used to enter the BoP markets are based on valuing and facilitating bottom-up co-invention, by ingraining a diversity of partners while building local capacity and being socially embedded. These strategies involve investing resources to develop capacity beyond the protective boundaries of the firm (London & Hart, 2004). So, the fundamental challenge may be one of business model innovation – breaking free of established mindsets, systems, and metrics that constrain the imagination of incumbent firms (Hart, 2007, p. 144).
Chapter 4: Synthesis

4.1: General Introduction

In the Opening of the thesis it was mentioned that a connection between DC and the BoP has already been made, by both Vermeulen et al. (2008) and Tashman and Marano (2010). The first however merely notes that DC and BoP are hard to distinguish empirically, but should be understood as different, although related phenomena. The secondly mentioned authors have focused on implementing and developing DC for the poor themselves (based on the fact that DC are the foundation for implementing routines) rather than discussing DC from a firm perspective. Tashman and Marano (2010) have thus focused on one of the four CSFs, namely ‘developing local capacity’, because teaching DC to the BoP is also a DC of a firm. However, the center of attention in this thesis is on distilling firm requirements through analyzing the BoP and DC literature. Therefore, this section will try to synthesize both concepts by analyzing to what extent DC provide solutions to the other three CSFs.

4.2: Synthesis

When one has read the previous chapters one has probably already seen some similarities between the two phenomena at hand. As will appear in this section, BoP is a radical case in the DC perspective. Generally speaking DC is used as a perspective to explain sustainable competitive advantage in turbulent markets. This way it is logical that BoP can be regarded from this perspective, because BoP markets are turbulent and have a need for innovation and therefore demand greater adaptability from engaging firms. Therefore, BoP engagement is placed on the extreme dynamic side of the DC continuum. It will follow from the next elaboration on similarities why BoP engagement is placed here. This way it is possible to investigate to what extent DC provide useful insight in the BoP.

Figure 9: BoP integrated in the DC continuum

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36 The connection of DC and BoP is already been made for the fourth CSF, namely ‘developing local capacity’. Therefore the focal point of the next section is to elaborate on the other three CSFs. Also the fourth CSF does not directly refer to actual DC firm requirements.

37 Of course one can object that there is no more radical version of a company than the Radical Dynamized company. This certainly is true. However, BoP goes farther than the literature of DC, and so the motivation to put BoP in an even more radical spot is to clearly show that DC has not revised all possible features of being Dynamic (which BoP now shows).
Firstly, it starts with recognizing that the focal markets show similarities (DC: e.g. Luo, 2000; BoP: Prahalad, 2009, pp. 11-18), for this please see figure 10. As DC are originally developed to adapt to changing environments, while they also are capable of creating new markets. Both are necessary in BoP engagement. One can observe that the BoP market is a more radical market than markets from the DC perspective, mostly because of the second similarity.

Secondly, both phenomena demand a transformation of their initial dominant logic (DC: e.g. Teece, 2007; BoP: e.g. Prahalad, 2009, p. 54), because otherwise change/success will not take place. The BoP goes one step further, because it even demands a reconfiguration of Western business logic.

Thirdly, both approaches emphasize collaboration with other parties (DC: e.g. Eisenhardt & Martin, 2000; BoP: e.g. London & Hart, 2004), in order to learn from them and hence create business opportunities. In addition to this, both approaches stress ample communication between all parties (particularly in the social markets of the BoP). BoP however goes farther by including fringe stakeholders. A further extension of the previous point refers to networking/social embeddedness capabilities (DC: Weerawardena et al, 2007; BoP: e.g. Viswanathan & Rosa, 2009), which is extra important for the BoP, because being socially embedded increases the necessary trust.

Fourthly, accompanied by the inclusion of other parties there is learning, which is vital for both DC and BoP (DC: e.g. Winter & Zollo, 2002; BoP: e.g. Prahalad, 2009, pp. 13-15). Learning is also here both the antecedent as well as the development of successful BoP engagement or DC implementation. Learning is
not restricted to existing knowledge, but also the creation of new knowledge is vital. It should be noted that at the BoP learning is more social in nature than in DC literature, because of the illiteracy at the BoP, which makes it more radical.

Fifthly, both DC and BoP highlight the importance of the reconfiguring or creation of business models (DC: Teece, 2007; BoP: e.g. Prahalad & Hart, 2002a). This is especially true for the BoP, because here thoroughly new business models need to be crafted with other stakeholders without being preoccupied with Western preliminary assumptions.

Sixth and final, the essential ingredient for successful BoP engagement, co-creation is also present in DC literature, where it is named the co-evolvement of products/services (DC: e.g. Eisenhardt & Martin, 2000; BoP: e.g. Hart, 2007, p. 196). Furthermore they both specifically stress remaining flexible in the product development stage by prototyping and early testing of products/services (DC: Eisenhardt & Martin, 2000; BoP: Simanis et al., 2008).

**4.3: Chapter Conclusions**

It appears that DC and BoP show significant overlap. The similarities lie in the market, the transformation dominant logic, collaboration with (numerous) other parties, importance of learning, transformation/creation business model, co-creation/co-evolving and learning DC to the BoP. Moreover, DC can be considered as the most radical case in a DC continuum. This has the implication that DC can give useful insights to the extent that DC has provided the most radical DC insights, because sometimes BoP goes farther by posing requirements yet unknown to DC. Subsequently, the firm requirements from the DC perspective that will be distilled are interpreted in its most radical form.
Chapter 5: Firm Requirements

This thesis has focused on the synergy of DC and BoP in order to find more specific company requirements for companies that seek successful BoP engagement. As there is abundant literature about what the BoP is and what companies should do, little has been investigated about the company requirements. These requirements however are possibly one of the most vital things to know, because it filters the potential amount of successful companies. Also, the DC perspective has been enriched by the BoP case, because the DC continuum has been stretched by the inclusion of the BoP. In order to provide an answer to the research question, the synergy of the two phenomena has generated the notion that DC can give useful insights from its most radical extent, because sometimes BoP goes farther by posing requirements yet unknown to DC. Therefore, this section allows the research question to be answered.

*What Company Requirements for Successful Engagement in the BoP can to what extent be gained from the DC Perspective?*

Firstly, Hart (2007, pp. 162-163) notes that MNC are the focal group of firms that should engage in the BoP because of their (international) resources, convening power, knowledge transfer possibilities, and up market transfer possibilities. In addition, they should be capable to become socially embedded, to co-invent solutions, work with nontraditional partners and develop local capacity (London & Hart, 2004). It should be noted that not every MNC is similar (Koen, 2005, p. 446), and thus it is necessary to complement the mentioned capabilities with DC requirements.

Before these specifics are discussed it is vital to make a distinction between the firm and the specific team (Vermeulen et al., 2008) that will actually be going to the BoP. One could say that the team itself should be radically Dynamically Capable because this team has to actually engage and perform at the BoP. The firm should be dynamically supportive (e.g. in investment strategies, on the continuum e.g. on Routinized Dynamization) in order to back the team up, so the firm is allowed to be somewhat less Dynamically Capable. So the forthcoming requirements should be interpreted most radically for the BoP team and to a lesser radical extent for the MNC itself (because the MNC has a supportive function, and

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38 Recap of the team according to Prahalad and Hart (2002a): managers should have creativity, imagination, tolerance for ambiguity, stamina, passion, empathy and courage, combined with analytical skill, intelligence and knowledge
Dynamic Capabilities and The Bottom of the Pyramid: Exploring Firm Requirements

should thus be capable of understanding the BoP process and demands and providing solutions for it that are found by the BoP team).

Using the BoP integrated DC continuum from Chapter 4, all the DC requirement can be interpreted radically. In short, it has (theoretically) been found that viewing from the DC perspective BoP engaging companies should be capable of:

- Being radically explorative (Tushman & O’Reilly, 2008) because BoP is drastically explorative in nature: every single action needs to be rethought and redesigned based on the knowledge creation from the BoP;
- Exploiting the three DC of Teece (2007) in the most radical fashion:
  - Sensing: that stimulate scanning, creation, learning, and market interpretation activities;
  - Seizing: creating the business model and investment decisions;
  - Reconfigure assets and organizational structures as the enterprise grows in order to minimize constraints that limit the seizing options of successive opportunities;
- Optimizing learning infrastructure and creating commitment (Luo, 2000);
- Optimizing contextual learning antecedents as autonomy, performance management, trust and support (Prieto et al., 2009);
- Minimizing/eliminating learning contingencies (Zollo & Winter, 2002):
  - A firm should be exceptionally open for change, acknowledge the radical turbulence of the BoP market and regard the task features as essentially important to learn;
- Optimizing the process of knowledge accumulation, articulation and codification (Eisenhardt & Martin, 2000);
- Forgetting previous company existence of position, processes and path (Teece et al., 1997):
  - Previous developments are likely to disrupt the radical DC implementation (Eisenhardt & Martin, 2000) or BoP engagement (Prahalad, 2009, p. 32);
- Learning the BoP DC, as a DC itself (Tashman & Marano, 2010);
- Mastering volatility by creating the ‘total learning organization’ (Schreyögg & Kliesch-Eberl, 2007).

One can conclude from this list that potential BoP engaging MNC, and moreover its team, should be capable of eliminating all limitations to learning and create the total learning organization from the

39 Remaining flexible is of utmost importance at the BoP, particularly when scaling out (Simanis et al., 2008)

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bottom up. When one interprets these conditions, one can understand that these conditions are quite demanding. Intuitively one would say that few companies are this Dynamically Capable. As no empirical data has been found concerning the amount of ‘total learning organizations’ there are, one can still make inferences on the following facts in order to put this outcome in perspective. Most firms do not or do not adequately assess their own market (Adams, Day & Dougherty, 1998) or try to successfully innovate or develop DC (Delmas, 2002), let alone transforming business models. Adams et al. (1998) state that together with numerous other studies, most firms have organizational learning barriers, as avoiding ambiguity, compartmentalized thinking, and inertia, that restrain real learning from taking place. This is especially true for disruptive learning (Clegg, Kornberger & Rhodes, 2005) which seems necessary for BoP engagement. In addition, Simonis (1997) adds that adequate collaborative learning is a hard challenge for companies, because they often do not assess what they already know, which prevents further learning. These facts gravely reduce the potential amount of successful BoP participants. As the Total Learning Organization is an exceptional demand for companies, this requirement can also be interpreted as a demand for the BoP team of the firm, where the itself firm is competent in providing support in a substantial DC fashion.

Therefore, this thesis recommends potential BoP companies to ask themselves the questions: “Are we capable of engaging in the most radically different environment known to business; can we handle all the uncertainties, and most importantly: are we or can we be that Total Learning Organization?” or more specifically: “Are we able to create the total learning organization by the BoP team and back this team up in a substantial DC fashion, considering the posed list of company requirements?”.

Future research could try to prove the company requirements by testing them empirically, by reviewing both successful and failed BoP engagers: both before they entered the BoP and while they were engaging the BoP. This way the requirements can be more detailed and concrete. In addition, interested companies or researchers could review literature about learning organizations in order to strengthen or expand the company requirements for BoP engagement.

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40 An additional view: a survey from Fortune 500 firms who are members of the Product Development and Management Association (PDMA) and found that only one method, focus groups, was used by more than 50% of the SBUs studied, and only two other methods (limited rollouts and concept tests) were used by more than 25% of the SBUs (from: Adams et al., 1998)

41 e.g. by inventing new investment criteria
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Appendices

Appendix A: Sensing, Seizing and Reconfiguring

Now the general idea is posed, it is vital to review the DC concept in more detail what DC are about. For this elaboration Teece (2007) will be used in order to further explain the three main DC: Sensing, Seizing and Reconfiguring. Each section is accompanied by a figure that further explicates the so-called microfoundations (in other words the actual practices/processes) of the DC, so that more transparency is offered to the reader.

A.1: Sensing

According to his definition, DC start with sensing capabilities. Sensing (and shaping) new opportunities is very much a scanning, creation, learning, and interpretive activity on technologies and markets, which is possible due to the fact that entrepreneurs have differential access to existing information and that new information and new knowledge (exogenous or endogenous) can create opportunities. It additionally involves understanding latent demand and the structural evolution of industries and markets. This capability can be both present in individuals as well as organizations that try to motivate this sensing behaviour. This requires specific knowledge, creative activity, and the ability to understand user/customer decision making, and practical wisdom by scanning and monitoring internal and external technological development as well as assessing customer needs (both expressed and latent). Furthermore, this external knowledge is to be obtained from collaboration with the core as well as to the periphery of their business ecosystem (e.g. potential collaborators, customers, suppliers, complementors, governments, research institutes), which implicitly refers to Chesbrough’s ‘Open Innovation’ (2003). Finally, Teece (2007) adds that the assessment of opportunities can be hypothesized and tested, for otherwise inconsiderate moves will be made (e.g. seizing a bad opportunity or wasting a good one).
Figure 6: Microfoundations of the Sensing capability

A.2: Seizing

Once a new opportunity is sensed it must be addressed through new products, processes or services. More specifically, one strategizes investment decisions, getting the timing right, building on increasing return advantages, and leveraging products and services from one application to another. This means that an enterprise must select or create a particular business model that defines its commercialization strategy and investment priorities (organizational innovation). In addition, these business models should be supported through organizational understanding. The management should thus transform internal views so that an understanding is created. In addition, the management is sensitive to the presence of certain biases in accepted investment decision processes. Excessive risk aversion or taking, as well as excessive optimism and pessimism should be avoided. In short, both the actual business model and the social element should be managed in these cases of (perhaps radical) innovations. In the figure below, Teece (2007) presents a framework for the microfoundations of seizing opportunities.
A.3: Reconfiguring

The third element of DC comprises the ability to recombine and to reconfigure assets and organizational structures as the enterprise grows, and as markets and technologies change, so that later a successful routine or path can be escaped from in order to obtain new success or defy threats due to environmental changes\(^{42}\). Therefore, managers face and must overcome at least two constraints, namely cognitive limitations and framing biases that arise from established assets. These constraints follow from hierarchies, rules and procedures (routines) that are deemed successful that will later begin to constrain certain interactions and behaviours unnecessarily. Teece (2007) summarizes this reconfiguration as follows: "periodic if not continuous asset orchestration—involving achieving asset alignment, coalignment, realignment, and redeployment—is necessary to minimize internal conflict and to maximize complementarities and productive exchange inside the enterprise". Beneath, Teece (2007) explicates the microfoundations of the element of DC.

\(^{42}\) It is stated earlier that DC are the routines to learn new routines, whereas it now seems that this is only part of DC. One should notice that still all the three elements constitute DC and that the last element, reconfiguring assets, provides a subsequent protection to new inertia (otherwise Dynamically Capable firms would become Dynamically Incapable when they have adapted to the market once).
Dynamic Capabilities and The Bottom of the Pyramid: Exploring Firm Requirements

Figure 14: Microfoundations of the Reconfiguring Capability
Appendix B: More elaboration on the BoP concept

“the poorest populations raise a prodigious new managerial challenge for the world’s wealthiest companies: selling the poor and helping them improve their lives by producing and distributing products and services in culturally sensitive, environmentally sustainable and economically profitable ways”
(Prahalad & Hart, 2002a)

B.1: Culturally Sensitive

So BoP engagement should be culturally sensitive. This refers to the ‘deep dialogue’ companies need to have with the poor in order to address the vital needs of the BoP (Hart, 2007, p. 196). Hence, it does not mean plainly selling to the poor as this previous quote suggests, but rather co-creating new products and services (Hart, 2007, p. 156). This nicely refers to the distinction between BoP 1.0 (merely ‘selling the poor’) and BoP 2.0 (creating mutual value) strategies, since the essence of effectively reaching the BoP lies in the co-creation and creation of mutual value (Hart, 2007, p. 195-196; Viswanathan, Seth, Gau & Chaturvedi, 2009). In the section ‘How’, more elaboration will follow on this BoP 2.0 strategy.

B.2: Environmentally sustainable

Additionally, environmentally sustainable is also important, since recreating Western consumption patterns (with environmentally damaging technologies) for the 4 billion poor will be disastrous (Prahalad & Hart, 2002a). Hart (2007, pp. xxxi-xxxix) notes that global capitalism now stands at a crossroads, and he uses stunning illustrations with adequate sources for this. Inter alia, examples are: growing income differences, 60% of the ecosystems are being degraded or used unsustainable and excessive growth of the human population (with all its consequences, particularly in the BoP). Hart (2007, p. xl) therefore regards the sustainable global enterprise as an entity that debases further development of these unsustainable forces.

B.3: Economically profitable

Lastly and perhaps most interesting for the contemporary private sector: profits can be made (Prahalad & Hart, 2002a)! According to Hart (2007, p. 140) philanthropy was and is an insufficient movement to create ‘a better world’. An indication: the West has spent $2.3 trillion on foreign aid over the past five decades with shockingly little to show for it. Especially, the way this foreign aid has been provided has received considerable criticism, because top-down prescriptions, lofty goals, large scale intervention have squelched the ability of local people to solve their own problems (Hart, 2007, p. 176). With the

BoP concept this should get turned around because in this concept they are co-creators of their solution and this should hence provide the private sector with profit opportunities (Prahalad, 2009, p. 74).

**B.4: BoP Success**

Finally, success in the BoP can be measured by the triple bottom line (Hart, 2007, p. 157) of economic prosperity, environmental quality and social justice, which is now better known as the three P’s: People, Planet and Profit. This BoP success depends on the capacity to adapt and innovate at the BoP (Prahalad, 2009, p9; Hart, 2007, p. 194). Again, one should not forget that the essence of the BoP concept lies in the co-creation with the ‘fourth tier’. For obtaining success, Simanis et al. (2008) even developed a rather ‘strict’ protocol in order to obtain this success.

So, it now appears that the only way to spur sustainable growth is to design a development strategy that focuses on the unmet needs in the developing world itself, the base of the pyramid. Indeed, the BoP concept holds the prospect of lifting the poor out of poverty, averting environmental meltdown, and opening the way to sustainable growth for the global economy (Hart, 2007, p. 134).

**B.5: Why should Companies invest in the BoP?**

Now that essence of the BoP concept is known, and which group has been targeted to use this concept, it seems an inevitable question to ask: ‘so why should the MNC utilize the BoP concept?’.

Firstly, the BoP concept focuses on the unmet needs of the poor (Prahalad & Hart, 2002a), but how can these needs be profitable? The answer to this is twofold. The first answer would be that the BoP represents a market of more than $20 trillion. Moreover, Hernando DeSoto estimates that there are well over $9 trillion in unregistered assets in the BoP (Hart, 2007, p. 117). Therefore, the BoP is not a market that should be ignored (Prahalad, 2009, p. 35). But still, how can profits be made of people that earn less than $2 a day? In underdeveloped markets the existence of the so-called ‘Poverty Penalty’, which results in the poor paying premium prices for their goods and services. These premium prices are the result of local monopolies, inadequate access, poor distribution, and strong traditional intermediaries (Prahalad, 2009, p. 35.; Hart, 2007, p. 116). The window of opportunity lies in the unlocking of this Poverty Penalty, and by virtue of the number of poor people, they represent a significant latent purchasing power (Prahalad, 2009, p. 35).

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44 Original creator of the concept: Elkington, J. in 1997
45 To put it in perspective, this $20 trillion market is comparable to the combined markets of Japan, the UK, France, Germany and Italy.
46 Research indicates that this Poverty Penalty is universal, but the magnitude of this difference differs per country and place. An example of the Poverty Penalty can be found in Dharavi, where the poor pay 5-25 times the prices of the rich people. Also the poor pay 600-1000% interest for lending money.
Secondly, there is a considerable and increasing difference between the growth rates of Western markets (stagnating) and (perhaps potential) growth rates of BoP markets, which now makes BoP markets becoming more interesting (Prahalad & Hart, 2002a; Hart, 2007, p. 111 & p. 117). These markets however, are informal (or: extralegal) for well over 50%, but interesting nonetheless (Hart, 2007, p. 117).

Thirdly, Prahalad (2009, pp. 73-84) distinguishes four sources for opportunities:

- Some BoP markets are large and attractive as stand-alone entities, or in other words, explosive growth is possible when the market’s ‘sweet spot’ is found;
- Many local innovations can be leveraged across other BoP markets, creating global opportunity for local innovations;
- Some innovations from the BoP markets will find applications in developed markets. Hart (2007, pp. 120-121), supports that per definition BoP markets are most suitable and profitable for innovations;
- Lessons from the BoP markets can influence the management practices of global firms, as for example on capital intensity, sustainable development and innovations.

Fourthly and finally, there are poverty alleviation and sustainability. As mentioned before, the BoP concept provides means to increase these two elements. It is stated by Hart (2007, p. 20, p. 55) that the human being will not even survive end of century if they do not try to improve these two facets.

To conclude, the BoP concept offers a rather great opportunity for companies to create a better world (poverty alleviation and sustainability) and reap profits simultaneously (Prahalad, 2009, p73-74).

B.6: Local Capacity Development: The Poverty Penalty

Local capacity building is needed because in BoP markets the resource shortages of the poor are not limited to financial, but extend to a lack of information, education and basic infrastructure (e.g. transportation and sanitation), that result in the inability to work, and a lack of market access (Viswanathan, Sridharan & Ritchie, 2009b). In addition, London et al. (2009) provides a more detailed analysis about what the constraints are that are faced by BoP producers (see figure 6). All in all, these constraints refer to the poverty penalty: In underdeveloped markets the existence of the so-called

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47 An illustration for support: a few years ago in India 3 million mobile telephones were sold each month (Tegenlicht: ‘de laatste markt’, June 11, 2007)
48 An indication: whereas changes were played out in 15 years in the developed world, in the BoP markets these took only 3-5 years. In other words, the S curve for market penetration in BoP markets is increasingly steeper.
‘Poverty Penalty’, which results in the poor paying premium prices for their goods and services. These premium prices are the result of local monopolies, inadequate access, poor distribution, and strong traditional intermediaries (Prahalad, 2009, p. 35; Hart, 2007, p. 116).

Eventually, BoP engagement will create ‘inclusive capitalism’, and hence this will ensure that the BoP is not solely dependent on their land’s offering, but also on what the world offers. Consequently, this provides poverty alleviation opportunities (Prahalad, 2009, p. 29).

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49 Research indicates that this Poverty Penalty is universal, but the magnitude of this difference differs per country and place. An example of the Poverty Penalty can be found in Dharavi, where the poor pay 5-25 times the prices of the rich people. Also the poor pay 500-1000% interest for lending money.

50 This, in short, refers to a form of capitalism in which not only the rich, but also the poor of the world are included (and thus not ignored, as they presently are said to be)