



## Bottom of the Pyramid Strategy and Financial Performance of Commercial Banks: *An Assessment of Agency Banking Operations in Kenya*

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### Abstract

Many organizations in Kenya banks included are reaping from clients at the bottom of the economic pyramid. High competition in the banking industry, has prompted banks to venture into this market segment to improve their financial performance. Agency banking was institutionalized in 2010 by The Central bank of Kenya to increase financial inclusion in the country. Commercial Banks licensed for agency banking have been registering a significant performance after introduction of agency banking. The general objective of the study was to establish the effects of bottom of the pyramid strategy on the financial performance of commercial banks through Agency Banking in Kenya. This study used descriptive research design. A census survey was carried out on all commercial banks undertaking Agency Banking. Data collected were analyzed by the use of descriptive statistics using Statistical Package for Social Sciences (SPSS) and presented through percentages, means, standard deviations and frequencies and multiple regressions. The study revealed that Commercial Banks use agency banking to target the low income market segment in rural villages and urban slums. From the findings 57.4% of the financial performance of these banks is attributed to combination of the four independent factors (business growth, cost-saving approach, innovation and new partnerships)

**Key Words:** *Agency Banking, Bottom of the Pyramid (BOP) strategy, Commercial Banks, financial performance.*

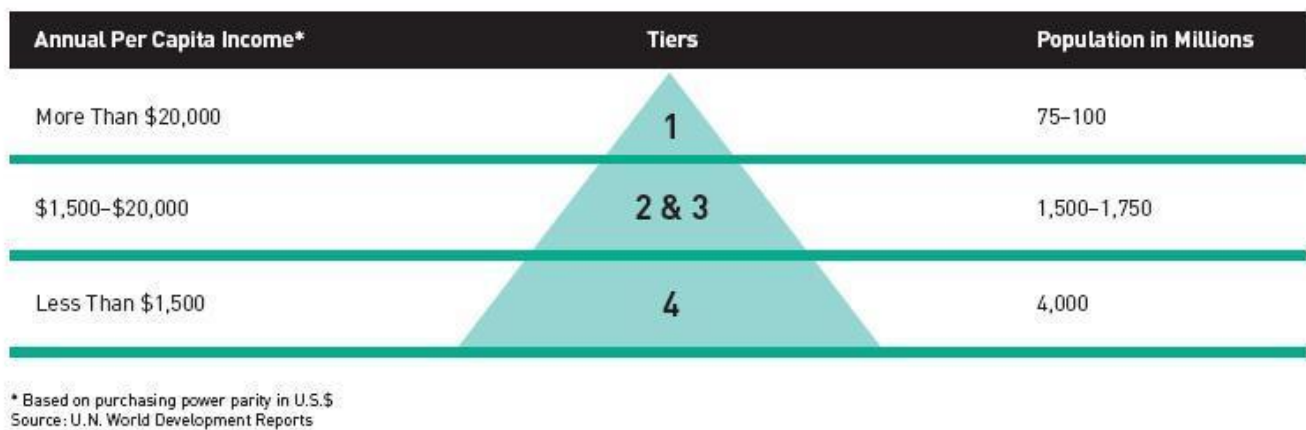
### 1.0 Introduction

The phrase “bottom of the pyramid” is used in particular by people developing new models of doing business that deliberately target BOP demographic, often using new technology. This field is also often referred to as the “Base of the Pyramid” or just the “Bop” (Prahalad, 2002). A growing number of global companies which include financial institutions are being drawn to the seductive idea that money can be made by developing and marketing products for those at the bottom of the pyramid (Karnani, 2007). Vachani and Smith (2008) conceived that BOP strategy is about giving the huge population base living on less than \$2/day access to solutions that completely improve their well-being. The strategy of encouraging companies to generate profits by producing goods and services for consumers at the Bottom of the Pyramid (BOP) has emerged as an important weapon in the companies endeavor to maximize their profits. The BOP concept is built around three pillars that can also be termed as its key principles. These are the principles of availability, accessibility and affordability (Hammond, Kramer, Tran, Katz and Walker, 2007). From the perspective of the private sector, to gain strategic competitive advantage that is sustainable and profitable; one needs to address the immediate and distant needs and realities of the BOP. These realities and needs are encrypted in the basic code of the BOP as value-conscious consumers who aspire to fully participate in and benefit from the mainstream economy, consumers who have been accustomed to living in expensive economies due to limitations and negative externalities of market economics resilient and creative entrepreneurs who over time have perfected the ability to produce using recycled or limited resources as indicated by Gardetti (2005).

According to Prahalad (2004), marketers who believe that the BOP is a valuable un-served market also believe that even the poor can be good customers. Despite their low level of income, they are discerning consumers who want value and are well aware of the value brands favored by more affluent consumers. This school of thought recognizes the obstacle that low income creates. It postulates that if companies take the correct steps and devote sufficient resources to satisfying the needs of the BOP, they can overcome barriers to consumption. The bottom of the pyramid approach to earning corporate profits has gained considerable attention in the world today. It has awakened managers to the potential of serving an un-served market and alleviating the level of global poverty while still making a profit (Harjula, 2005). The reason being studies done so far portray the low income group as motivated by similar desires as the rich. They want quality products and any company that can supply those products at the right price will gain their loyalty. According to Martinez and Carbonell (2007) some of the companies venturing there have used the strategy of reducing the effective price of products through economies of scale in packaging and developing lower cost sizes. Emphasis is on the untapped potential of the BOP, and models that companies may use to tap that potential. According to Prahalad (2004) the fortune at the bottom of the pyramid is at the top of the reading list for business people, academics and experts pursuing the elusive goal of sustainable growth in the developing world. There is significant untapped opportunity for value creation (for BOP consumers, shareholders and employees) that is latent in the BOP market. These markets have remained “invisible” for too long. The BOP literature suggests that many for-profit companies have the misconception of the BOP segment as a huge market with homogeneous consumers, many times labeled simply as “blue-collar,” “working class,” or “popular class.” In reality, however, low-income consumers differ in several aspects and many sub-segments may coexist (Emmons, 2007).

**Figure 1:** The World Economic Pyramid

## The World Economic Pyramid



### 1.1.1 Agency Banking and Bottom of Pyramid Strategy

An agency bank is a company/organization that acts in some capacity on behalf of another bank, it, thus, cannot accept deposits or extend loans in its own name; it acts as agent for the parent bank. It is a retail outlet contracted by a financial institution or a mobile network operator to process clients' transactions. Rather than a branch teller, it is the owner or an employee of the retail outlet who conducts the transaction and lets clients deposit, withdraw, and transfer funds, pay their bills, inquire about an account balance, or receive government benefits or a direct deposit from their employer (Central Bank of Kenya, 2014).

Agency banking model requires commercial banks to rely on the existing infrastructure in terms of supermarkets, credit unions, hotels and petrol stations to reach out to customers. Agents can be limited liability companies, cooperative societies, parastatals, trusts, partnerships or individuals. Any entity which is faith-based or not-for-profit, a non-governmental organization, an educational institution, forex bureau or any other entity which, under any applicable law is not allowed to carry on profit-making business shall not engage in agent banking business. Agents are selected based on their network, services to be provided, anti-money laundering procedure, strategy and financial projections envisioned from agency business (Wafula, 2011). Any stable and efficient agency banking system depends on technology that enables banks and customers to interact remotely. Banking agents need to be equipped with a point-of-sale (POS) card reader, a mobile phone, a barcode scanner to scan bills for bill payment, Personal Identification Number (PIN) pads, and sometimes personal computers (PCs) that connect with the bank's server using a personal dial-up or other data connection; good infrastructure means a high degree of interoperability. It also depends on effective delivery channels. In 2010, Central Bank of Kenya (CBK) issued guidelines for agency banking, shepherding banks to start recruiting retailers as agents in developing channels (CBK, 2014).

According to the FinAccess National Survey (June, 2009), banks have billions at their disposal yet most of this goes to big corporate organizations and high net worth clients while the majority of Kenyans remain excluded, with only 23 per cent of the country's population aged above 18 years holding bank accounts. A recent World Bank survey into Kenya's financial sector vindicates this survey, showing that 34 per cent of the population is excluded from access to financial services, but still puts Kenya ahead of her peers in the East African region (Beck, Cull, Fuchs and Getenga, 2010). To enhance financial market access, Banking Act was amended to pave way for agency banking. Agency banking in Kenya was institutionalized in 2010 through Guideline on Agent Banking, issued by the Central Bank of Kenya (CBK). The document prescribes the manner in which agent banking business should be carried out in Kenya in order to ensure the supervision, safety and soundness of the banking sector. According to the agent banking regulation, agent shall be an existing well established commercial activity which has been operational for at least 18 months immediately preceding the date of the suitability assessment, has not been classified as a deficient, doubtful or non-performing borrower by an institution in the last 18 months preceding the date of signing the contract and possesses appropriate physical infrastructure and human resources to be able to provide the services with the necessary degree of efficiency and security (CBK, 2014).

As 31<sup>st</sup> March 2013 CBK had licensed 11 Commercial banks to carry out agent banking business and approved 18,082 specific agents. This was an increase from 10 banks that had contracted 16,333 active agents facilitating over 38.7 million transactions valued at Ksh. 195.8 billion in December 2012 (CBK website accessed on 11<sup>th</sup> November 2014). However, many are finding that agents lack capacity to handle large transactions of cash and under-spend on security measures, thus, negating potential clients' confidence in them. Besides this, agency banking has received a blow as many of the available outlets (agents) have already been snagged by mobile phone companies, who have relied on their agents to fast-track uptake of mobile money solutions such as *M-Pesa*, *YuCash*, *Orange Money* and *Airtel Money* (Okuthe, 2010). Commercial banks in Kenya have registered a significant performance over four years 2010-2013 after introduction of agency banking.

### 1.1.2 Bottom of the Pyramid Strategy and Financial Performance

Prahalad (2004) proposes that businesses, governments and donor agencies should stop thinking of the poor as victims and instead start seeing them as resilient and creative entrepreneurs as well as value-demanding consumers. There are tremendous benefits to multi-national companies who choose to serve these markets in ways that respond to their needs. After all the poor of today may be the middle-class of tomorrow.

Businesses can gain competitive advantage and therefore sustained profitability by targeting the poor at the bottom of the economic pyramid (Martinez & Carbonell, 2007). The basic premise behind the BOP concept is that of a

“customer-driven” approach that enables a company to focus on individual customers and thus improve its profitability by serving these customers in a differentiated manner. Karnani (2006) states that a key aspect of establishing an entrepreneurial mindset is, “creating the conditions under which everyone involved is energized to look for opportunities to change the business model.” This can be done through re-designing existing product offerings and re-shaping markets. The best examples of companies that are benefiting from the bottom of the pyramid strategy are the commercial banks targeting the low and mid income earners.

## 1.2 Statement of the Problem

Commercial Banks that have embraced agency banking have created partnership with the BOP by increasing availability, accessibility and affordability of their products through agency banking. They have also registered a significant performance after introduction of agency banking. Therefore it is important to investigate this performance whether it is attributed to Agency banking. Scanty systematically documented information was found that relates the Agency banking and financial performance. The study therefore sought to establish the effects of bottom of the pyramid strategy on the financial performance of commercial banks in Kenya through Agency Banking.

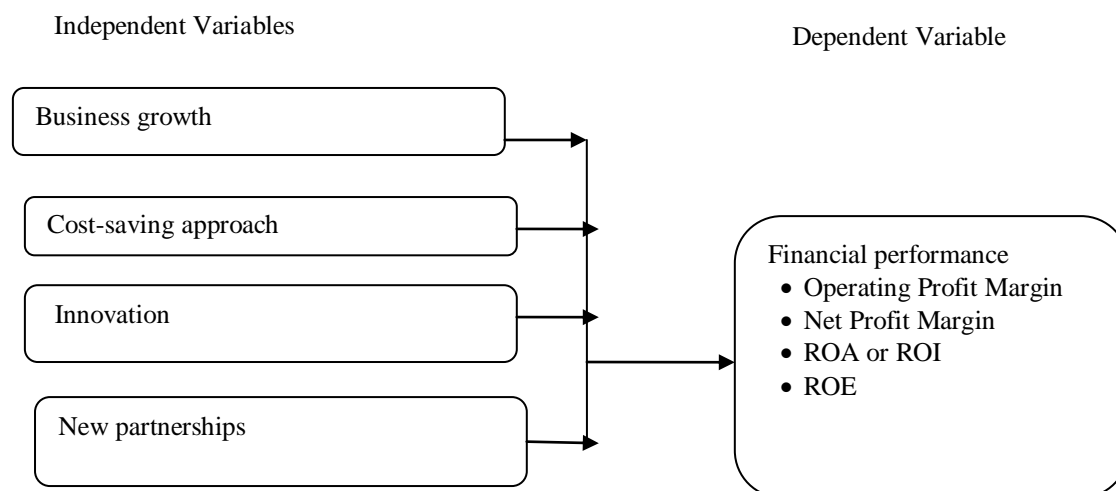
The specific objectives of the study were:

- To determine the effects of business growth approaches on financial performance of commercial banks in Kenya
- To establish the effects of cost-saving approaches on financial performance of commercial banks in Kenya
- To assess the extent to which innovations affects financial performance of commercial banks in Kenya
- To determine the effects of partnerships on financial performance of commercial banks in Kenya

## Conceptual Framework

The following conceptual framework (figure 2) guided the direction of the study, where the independent variables were tested against the dependent variable measured in terms of Operating Profit Margin, Net Profit Margin, ROA or ROI and ROE.

**Figure 2:** Conceptual Framework



## 3.0 Research Methodology

This study used a descriptive research design. The study took a census survey of commercial Banks licenced by CBK for agency Banking. Data collected were analyzed by the use of descriptive statistics using Statistical Package for Social Sciences (SPSS).

### The model

The researcher conducted a multiple regression analysis so as to determine the relationship between the financial performance of Commercial Banks and four elements that were investigated in the study. The regression equation ( $Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \epsilon$ ) was:

Where:  $Y$  = Financial performance of Commercial Banks through agency banking

$\beta_0$  = Intercept

$X_1$  = Business growth

$X_2$  = Cost-saving approaches

$X_3$  = Innovations

$X_4$  = Partnerships

$\epsilon$  = Error term

## 4.0 Results and Discussion

### 4.1 Agency Banking

The study revealed that Commercial Banks use agency banking to target the low income market segment in rural villages and urban slums. Majority (60%) of the respondents indicated that the strategy of targeting the market segment in rural villages and urban slums through agency banking improved the financial performance of Commercial Banks to a very large extent. Agency banking affects the return on investments to a great extent as shown by a mean score of

4.4962, as well as net profit margin as shown by a mean score of 4.1579, return on assets as shown by a mean score of 4.1504, operating profit margin by a mean score of 3.9699 and return on equity as shown by a mean score of 3.9549.

Table 1: Effects of Agency banking on financial Performance

Aspects of Financial Performance						Mean	Std dev
	No extent	Little extent	Moderate extent	Large extent	Very large extent		
Operating Profit margin	11.3	0	18.8	20.3	49.6	3.9699	1.30813
Net profit Margin	7.5	0	13.5	34.6	44.4	4.1579	0.92803
Return on Investments	0	0	12	26.3	61.7	4.4962	0.70307
Return on Assets	3.8	15.8	4.5	13.5	62.4	4.1504	1.27622
Return on Equity	3.8	5.3	27.8	18	45.1	3.9549	1.13394

#### 4.2 Business growth and financial performance

The study found that business growth affects the financial performance of Commercial Bank to a very great extent as indicated by 40% of the respondents. Majority of the respondents, shown by 70%, agreed that low income earners represent an opportunity for fundamentally new sources of growth which has the potential to be very rapid. Majority of the respondents indicated that low income earners are ill-served by existing supply chains hence easier to tap enhancing profits and improving financial performance of the company to a great extent as shown by a mean score of 3.5417 and that low income markets supports growing new product lines and revenue generation to a great extent as shown by a mean score of 3.5208, while large and lucrative market at the low income segment enhances sales thus improving the financial performance of commercial Banks to a moderate extent as shown by a mean score of 3.3333 as well as companies seeking more revenues are targeting the vast pool of consumers in the low income bracket as shown by a mean score of 3.2917.

#### 4.3 Cost Saving Approaches and Financial Performance

The study also found that cost-saving approaches affect the financial performance in the Banks to a great extent as indicated by 44% of the respondents. Majority of the respondents indicated that distribution and technology investments affect the financial performance of the bank to a great extent as shown by a mean score of 4.4962, as well as productivity shown by a mean score of 4.1579, outsourcing shown by a mean score of 4.1504 and capital/resources shown by a mean score of 3.9699. Majority of the respondents agreed that competing in low income markets is a powerful source of learning that can translate to efficiencies in rural markets thus affecting the financial performance of Commercial Banks to a great extent as shown by a mean score of 3.9549, targeting low income marketing leads to the increasing prominence in banks and the growth of a substantial industry affects the financial performance of Commercial Banks to a great extent as shown by a mean score of 3.6875, while low income markets enhance capturing potential supply chain efficiencies in banking affects the financial performance of Commercial Banks to a moderate extent as shown by a mean score of 3.3750 and marketing at the low income markets creates large economic value for shareholders affects the financial performance of Commercial Banks to a moderate extent as shown by a mean score of 2.7500.

Table 2: Effects of Cost-Saving Efficiencies on Financial Performance of Commercial Banks

Cost-Saving Efficiencies						Mean	Std dev
	No extent	Little extent	Moderate extent	Large extent	Very large extent		
Capital/Resources	11.3	0	18.8	20.3	49.6	3.9699	1.30813
Productivity	7.5	0	13.5	34.6	44.4	4.1579	0.92803
Distribution and Technology Investment	0	0	12	26.3	61.7	4.4962	0.70307
Outsourcing	3.8	15.8	4.5	13.5	62.4	4.1504	1.27622

#### 4.4 Innovation and Financial Performance

The study further established that innovation usually involves change in ways of doing things in a simpler and cheaper way and as such, 60% of the respondents indicated that innovation affects financial performance of the Banks to a great extent. Majority of the respondents indicated that technology innovations affect the financial performance of commercial banks to a great extent as shown by a mean score of 3.770, product innovations affect the financial performance of the Banks to a great extent as shown by a mean score of 3.625, while market innovations affect the

financial performance of the Banks to a moderate extent as shown by a mean score of 3.187 as well as process innovations to a moderate extent as shown by a mean score of 2.625. Majority of the respondents agreed that offering the best service to the markets affects financial performance of the Banks as shown by a mean score of 3.6875, identifying better (new) potential markets affects financial performance of the Banks as shown by a mean score of 3.5489, as well as product development is important in both the supply of the core product as well as in the support part of any offer affects financial performance of the Bank as shown by a mean score of 3.5000. The respondents remained neutral on that product development that are radical, inventive and early offer greater rewards and performance improvement as shown by a mean score of 3.2500, generating better (new) ways to serve target markets as shown by a mean score of 3.2500, improving the mix of target markets as shown by a mean score of 3.2083 and helps in market segmentation as shown by a mean score of 3.1250.

**Table 3: Innovation approaches and financial performance of Commercial Banks**

Innovation Approaches						Mean	Std dev
	No extent	Little extent	Moderate extent	Large extent	Very large extent		
Technological innovations	27.1	37.5	6.3	14.6	14.6	3.770	1.1842
Product innovations	2.1	16.7	10.4	60.4	8.3	3.625	1.0026
Market innovations	10.4	29.2	6.3	39.6	14.6	3.187	1.2990
Process Innovations	10.4	50	12.5	20.8	6.3	2.625	1.1227

#### 4.5 Partnerships and Financial Performance

The study finally found out that new partnerships affect the financial performance of Commercial Banks to a great extent as indicated by 47% of the respondents. Majority of the respondents indicated that access to customers through agency banking affect the financial performance of the Banks to a great extent as shown by a mean score of 4.4962 as well as market knowledge to a great extent as shown by a mean score of 4.1579, customer base to a great extent as shown by a mean score of 3.9699, customer satisfaction to a great extent as shown by a mean score of 3.6875, innovative packaging to a great extent as shown by a mean score of 3.5489 and services delivery models through agency banking affect the financial performance of the Banks to a great extent as shown by a mean score of 3.5000. Majority of the respondents indicated agreement that advanced technology is used to reach low income earners in partnerships as shown by a mean score of 4.125, the low income market is served with different established businesses to partner with through agency banking as shown by a mean score of 4.000, the low income markets enhance development in the form of partnerships with telecommunications and other industry businesses as shown by a mean score of 3.9375 and that targeting the low income earners to provide basic solutions requires partnering with accessible business locations as shown by a mean score of 3.7500. All these approaches of new partnerships through agency banking are found to affect the financial performance of Commercial Banks.

**Table 4: Partnerships aspects and financial performance of Commercial Banks**

Aspects of Partnerships through agency banking						Mean	Std dev
	No extent	Little extent	Moderate extent	Large extent	Very large extent		
Customer base	11.3	0	18.8	20.3	49.6	3.9699	1.310
Market knowledge	7.5	0	13.5	34.6	44.4	4.1579	0.930
Access to customers	0	0	12	26.3	61.7	4.4962	0.700
Services delivery models	0	0	54.2	41.7	4.2	3.5000	0.590
Customer Satisfaction	6.3	12.5	18.8	31.3	31.3	3.6875	1.2500
Innovative packaging	2.3	27.1	6.8	41.4	22.6	3.5489	1.1772

#### 4.6 Regression Results

To achieve the study objectives, multiple regression was used. Adjusted  $r^2$  was used to measure the strength of the relationship between the variables. Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (Financial Performance of the Commercial Banks through agency banking) that is explained by independent variables (Business growth, Cost saving approaches, Innovations and partnerships).

**Table 5: Coefficient of Determination**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.757(a)	.574	.533	.91241

From the findings 57.4% of the financial performance of Commercial Banks is attributed to combination of the four independent factors (business growth, cost-saving approach, innovation and new partnership) investigated in this study. A further 42.6% of the financial performance of Commercial Banks is attributed to other factors not investigated in this study.

**Table 6: Multiple Regression Analysis**

Model		Unstandardized Coefficients		Standardized	t	Sig.
		B	Std. Error	Coefficients		
1	(Constant)	0.713	1.068		0.799	0.033
	Business growth	0.246	0.203	0.135	0.619	0.036
	Cost-saving approach	0.359	0.193	0.08	0.358	0.014
	Innovation	0.268	0.250	0.242	0.891	0.023
	New partnership	0.215	0.16	0.346	1.284	0.044

Dependent Variable: Financial Performance of Commercial Banks through agency banking

The established regression equation was:  $Y = 0.713 + 0.246X_1 + 0.359X_2 + 0.268X_3 + 0.215X_4 + 0$

According to the regression equation established, taking all factors of bottom of the pyramid strategy through agency banking (business growth, cost-saving approach, innovation and new partnership) constant at zero, the financial performance of Commercial Banks as a result of these independent factors will be 0.713. The data findings analyzed also shows that taking all other independent variables at zero, a unit increase in business growth will lead to a 0.246 increase in financial performance of Commercial Banks. A unit increase in cost-saving approach will lead to a 0.359 increase in financial performance of Commercial Banks; a unit increase in innovation will lead to a 0.268 increase in financial performance of Commercial Banks while a unit increase in new partnership will lead to a 0.168 increase in financial performance of Commercial Banks. This therefore implies that all the four variables have a positive relationship with cost-saving approach contributing more to the financial performance of Commercial Banks, while new partnership contributes the least to the financial performance of Commercial Banks.

## 5.0 Conclusion and Recommendations

### 5.1 Conclusion

On objective one, it concludes that business growth approaches affect the financial performance of commercial banks. As such low income earners represent an opportunity for fundamentally new sources of growth which has the potential to be very rapid, low income earners are ill-served by existing supply chains hence easier to tap thus enhancing profits and therefore affecting the financial performance of Commercial Banks through Agency Banking. On objective two, it concludes that cost-saving approaches affect the financial performance of commercial banks through distribution and technology investments, productivity, outsourcing and capital/resources. Competing in low income markets is a powerful source of learning that can translate to efficiencies in rural markets.

On objective three that innovation affects financial performance of commercial banks. Technology innovations, product innovations, market innovations as well as process innovations affect the financial performance of the Banks. The study established that offering the best service to the markets, identifying better (new) potential markets as well as product development is important in both the supply of the core product as well as in the support part of any offer affects financial performance of the Company. While on objective four it concludes that new partnerships affect the financial performance of commercial Banks. Access to customers, market knowledge, customer base, customer satisfaction and services delivery models through agency banking affect the financial performance of the Banks. Advanced technology is used to reach low income earners in partnerships, the low income market is served with different established businesses to partner with through agency banking, the low income markets enhance development in the form of partnerships with telecommunications & other industry businesses and targeting the low income earners to provide basic solutions requires partnering with accessible business locations.

In overall this implies that Commercial Banks targets the market segment in rural villages and urban slums which affects its financial performance. The financial performance of Commercial Banks is attributed to combination of business growth, cost-saving approach, innovation and new partnership. The four variables have a positive relationship with cost-saving approach contributing more to the financial performance of Commercial Banks, while new partnership contributes the least to the financial performance of Commercial Banks.

### 5.2 Recommendations

From the study findings and conclusions, the study recommends that for the Banks to realize better financial performance in its endeavors, it needs to focus on various aspects of business growth in the bottom of the pyramid such as focusing on the ill-served, generation of new product lines and revenue generations; Commercial banks should enhance their financial performance though cost-saving approaches which include distribution and technology investments, productivity, outsourcing and capital/resources.

Further, Banks and other companies seeking to create new markets addressing the needs of the billions of poor people living at the bottom of the economic pyramid should use that effort to drive sustainability and innovation within their own ranks. Higher profits can be realized through enhancing technology innovations; product innovations, market innovations as well as process innovations. And that Commercial Banks should focus on new partnerships with other players in various industries such as mobile telecommunication and other sectors where agency banking can enhance reaching the market at the bottom of the pyramid for easier access to customers, market knowledge, customer base, customer satisfaction and services delivery models. New partnerships at the bottom of the pyramid would ensure affordability of services, the low income markets would enhance development, targeting the low income earners would



provide basic solutions and would ensure that the low income market is much better served through advanced technology.

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