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Strategic motivations and choice in subsistence markets

Raed Elaydi [a,*], Charles Harrison [b,*]

[a] University of Illinois at Chicago, United States
[b] University of Pennsylvania, United States

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ABSTRACT

This paper examines the different motivations behind strategic choice in base of the pyramid or subsistence markets. Two strategies are examined through comparative analysis: *market extension* and *strategic intent*. Using two commercial bank's micro-lending business strategies in Sri Lanka, a comparative case study suggests that strategic intent is motivated by building capabilities over time that results in successful poverty alleviation, whereas market expansion is motivated by an immediate desire to expand overall sales revenue. This conclusion may help reframe subsistence market or BoP arguments away from such false choices as appropriate size (e.g., multinational corporations versus small and medium size enterprises) toward more useful discussion on understanding *why* firms participate in subsistence markets and what is the motivation behind their strategic choice. By considering more than just size and scope and studying the motivations behind long-term solutions to poverty alleviation, firm success can be better understood and achieved.

1. Introduction

The current discussion investigates to what extent firms' motivations for participating in subsistence markets informs their business strategy and ultimately results in long-term poverty alleviation. This paper analyzes the participation of a large national and multinational firm in subsistence markets. This analysis and comparison of two commercial bank's micro-lending business strategies in Sri Lanka suggests that the motivation for entering into a subsistence market has a large impact on choice of strategy, partnerships, scale, and means of entry. Firms motivated by strategic intent while engaging in subsistence markets build on past initiatives, engage and grow with the community, and create local knowledge and expertise (Hamel and Prahalad, 1989). On the other hand, firms with a *market expansion strategy* exploit existing pent-up demand and novelty expertise (Bang and Joshi, 2008). The contrast between the two strategies suggests that strategic intent is motivated by building capabilities over time that result in successful poverty alleviation, whereas market expansion is motivated by an immediate desire to expand overall sales revenue expertise. This case study highlights how the subsistence market needs imaginative, long-term responses to poverty alleviation to create what is possible in subsistence markets.

The paper first discusses both Hatton National Bank (HNB) and Hong Kong Shanghai Banking Corporation's (HSBC) participation in Sri Lanka's subsistence market with an introductory history of each firm. Second, the paper provides a comparative case analysis of the two firms' strategies, motivations, and outcomes. From the insights of the case analysis, a discussion and interpretation of the events focuses on the firm's strategic motivation. Motivations are defined and interpreted by two strategies — market extension and strategic intent.

2. Case studies in subsistence markets

Case analysis is an effective way to examine the textured role motivation and strategy play when firms engage in subsistence markets. The main bank initiatives discussed are HNB's Barefoot Banker and HSBC's credit card business. HNB's micro-lending initiatives focused on bringing world-class financial services to the subsistence markets through their village adoption program and having employees of the bank become members of the community. This long-term strategy to grow and develop with the community is a multi-decade approach that is fully incorporated into the bank's overall business strategy (Gallardo et al., 1997). In contrast, HSBC's entrance into the Sri Lankan credit card business grew to a dominating 36% market share with the help of new customers from the subsistence markets (Nicolaou, 2008). Though engaging the subsistence market and making credit cards available to the poor, unforeseen consequences led to government intervention and new regulations (Sirimanna, 2007).

Banking is a fitting industry to analyze subsistence markets because of its thirty-year history in micro-financing. Further, the two traditional commercial banks, HNB and HSBC, are exemplary because of their long history in Sri Lanka and their different

* Corresponding authors. Elaydi is to be contacted at the University of Illinois at Chicago, 2231 University Hall, 601 S. Morgan, M/C 243, Chicago, IL 60607-7123, United States. Harrison, University of Pennsylvania, The Caster Building, Room C-15, 3701 Locust Walk, Philadelphia, Pennsylvania 19104-6214, United States.
E-mail addresses: relaydi@gmail.com (R. Elaydi), hcharles@sp2.upenn.edu (C. Harrison).

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approaches to engaging with poverty and the rural community, specifically, HNB's thirty-five-year history of engaging with the poor. Lastly, Sri Lanka is an understudied nation with a rich tradition of poverty alleviation, with various firms trying to have an impact on their communities. As such, Hatton National Bank and HSBC are reviewed separately discussing each firm's history and engagement strategy in subsistence markets.

2.1. Hatton National Bank

The Bank known as Hatton National Bank was established in 1888 as the Hatton Bank primarily to attend to the developing tea industry of central Sri Lanka. Hatton National Bank (HNB) is a public limited liability company incorporated on March 5, 1970 in Colombo, Sri Lanka. Prior to incorporation, HNB joined with some branches of National and Grindlays Bank and was renamed Hatton National Bank in 1970 (Theagarajah, 2009). HNB is a premier private-sector bank in Sri Lanka. HNB manages and operates 177 Customer Centers in Sri Lanka and two representative offices in India and Pakistan with a total of 4395 employees (HNB Annual Report, 2008).

This traditional commercial bank offers a wide variety of financial services, including corporate and investment banking, retail banking, international banking, development finance, equities, fixed income, and insurance. HNB also addresses the span of markets from large corporations and high net-worth individuals to mass-market retail and microfinance. Corporate banking represents the bulk of the HNB's income and credit portfolio. HNB's stature and reliability have led to the development of banking relationships with most Sri Lankan blue-chip companies and foreign multinational corporations (FMNCs) within the country (HNB Annual Report, 2008). However, this traditional commercial bank's core business strategy incorporates the development of subsistence markets and poverty alleviation (Gallardo et al., 1997).

HNB has worked with the rural poor in Sri Lanka for over 35 years. Over these decades, HNB has developed and grown with these communities. HNB entered rural financing in 1973 almost immediately after its establishment, beginning a village adoption program in the southern Monaragala district (Gallardo et al., 1995). The village adoption program included supporting community activities and providing financial services such as cultivation, animal husbandry, trading, and other self-employment projects. HNB's work in their village adoption program was borne out of their initial work (as Hatton Bank) in villages, which focused on helping local tea farmers in their “small industry-financing program” (Gallardo et al., 1997).

HNB's involvement in microfinance occurred shortly after becoming aware of, and gaining knowledge from Grameen Bank in Bangladesh (Gallardo et al., 1997). Inspired by Muhammad Yunus, HNB created its own model based on community engagement and participation (Gallardo et al., 1997). HNB's *Barefoot Banker* micro-lending initiative, created in 1989, permanently immerses an individual employed by HNB into the social fabric of a small rural village (Gallardo et al., 1997). The Barefoot Banker attends weddings, festivals and community events, while playing a leadership role and giving expertise to the community. Currently the bank has 117 Barefoot Bankers across Sri Lanka (HNB Annual Report, 2008). The many *bare feet* on the ground implement HNB's strategy, making investments in each individual, beyond traditional money transfers. These initiatives are part of HNB's long-term strategy of having a competitive platform in the rural sector (Gallardo et al., 1997).

HNB, motivated by the desire to think differently and approach their environment from a “what can we create” perspective, transformed rural banking in Sri Lanka. Such motivation has led to a microfinance portfolio with 70,000 micro-loans worth 5.4 billion LKR, and a successful repayment rate of 95% (Theagarajah, 2009). HNB's program, which has helped 50,000 rural families and over 500,000 people, has reconceptualized microfinance and pushed HNB to be the model of sustainable development (Theagarajah, 2009). Through social progress and a focus on customer care, HNB's microfinance initiative has emerged as a profitable banking model. HNB has now *fully integrated* their microfinancing program into their normal commercial banking operations (HNB Annual Report, 2008).

HNB's programs provide a means for people in rural Sri Lanka to gain access into the formal economy. For over 35 years, HNB has provided the rural poor access to world-class financial services. They accomplished this by first establishing the small industry-financing program, then a village adoption program and the Barefoot Banker, and most recently insurance for micro-entrepreneurs, (Gallardo et al., 1997; Theagarajah, 2009). Further, HNB set an ambitious goal of making banking accessible to subsistence markets by becoming part of the social network. The Barefoot Banker's membership and lifelong connection with the community is an example of relationship success leading to business success (Gallardo et al., 1997). Lastly, HNB focused their microfinance on uplifting and developing subsistence markets. For example, the Barefoot Banker initiative was introduced during a major youth insurgency in Sri Lanka (Gallardo et al., 1997). HNB's plan attempted to create jobs, investment, and entrepreneurship at the epicenter of the insurgency (Gallardo et al., 1997). The motivations and long-term strategies implemented and integrated in HNB's core business is in stark contrast to HSBC's engagement and involvement in the subsistence market.

2.2. Hong Kong Shanghai Banking Corporation

The Hong Kong Shanghai Banking Corporation (HSBC) was founded in 1865 by Thomas Sutherland to finance trade in the Far East. Since then HSBC has grown exponentially. HSBC maintains locations worldwide and surpassed Citigroup as the largest banking and financial services organization in the world, with profits of $16 billion and assets under three trillion dollars (Lanka Newspapers, 2006). In addition to their strong foothold in mature markets such as Hong Kong, Europe and the U.S., HSBC's business operations in emerging markets continues to grow rapidly. HSBC is operating in a variety of countries, including Sri Lanka, the Philippines, Singapore, Thailand, Myanmar, and Vietnam, with the Sri Lanka operations being the focus of this discussion (HSBC History, 2008). HSBC's entrance and relationship with Sri Lanka is a long and tenuous one.

Their venture into Sri Lanka began during the late 19th century after the Oriental Bank ceased operations. HSBC swiftly took the opportunity to profit during a very difficult time when the country was suffering economic turmoil from diseased coffee plants. HSBC is the first bank in Sri Lanka to develop an electronic banking system, which was connected to HSBC's Global Data Network, enabling financial information to interchange with clients instantaneously. From this, HSBC introduced the first ATM machines in Sri Lanka. With this significant strategic advantage, the bank gained a large share of the Sri Lankan credit card market (HSBC History, 2008). Without tellers or branches, HSBC extended their world-class electronic banking system of credit cards, ATMs and mobile phone banking to the subsistence market.

In Sri Lanka, HSBC was particularly successful with their credit card venture, selling roughly 100,000 credit cards before the completion of its inaugural year in 2006. In a little over 2 years, HSBC managed nearly 300,000 out of the approximately 828,000 credit cards in Sri Lanka (Nicolaou, 2008). HSBC began their venture by fully extending their credit card business into the subsistence market. To obtain an HSBC credit card, applicants could have limited identification and residency requirements, highly flexible employment verification, and minimal proof of monthly income — roughly Rs.10,000 or roughly $90.00 per month (Sirimanna, 2007). While the firm's strategy in Sri Lanka is a case example of being profitable, innovative, scalable, and accessible to the subsistence marketplace, the extension of existing products into these markets was not necessarily a responsible, long-