



Cross-Subsidisation and Segmenting by Quality

BUSINESS MODEL FEATURES FOR REACHING LOWER-INCOME CONSUMERS WITH NUTRITIOUS FOODS

The **GAIN Business Model Research Project** aims to identify promising business models to reach lower-income consumers with nutritious foods. This series of briefs summarises the results of the project's systematic review of existing research and evidence to identify these approaches.



Serving lower-income consumers: the business and nutrition opportunity

Lower-income consumers represent a large market, estimated at 4 billion people worldwide. Many low-income consumers' diets are lacking in food diversity and quality. There is a business opportunity for private companies to help improve this by providing safe, nutritious foods that meet customers' needs at an affordable price – as long as they do so in ways that are profitable and financially sustainable for the company.

HOW DOES IT WORK?

Where diversity exists in product quality or in customers, companies can leverage that to charge different prices for different products and/or to different customers.

This can make it so that the most price-sensitive lower income consumers face lower prices, which they are more able to pay, while the customers able to pay higher prices pay those prices and help make the firm's business viable.



In a cross-subsidisation model, one product is sold with a larger margin, with the excess profit used to subsidise another product sold at a smaller margin. This is often done by selling to an institutional market (e.g., a school meal programme or NGO) with a larger margin, with the savings passed on to the normal retail market.

Under quality segmentation, a product that exists in forms of different qualities is graded by quality, with lower-quality versions sold at cheaper prices. This approach can also be used for aspects of quality other than the product itself – for example, packaging the same product in a cheaper packaging format with limited branding for a low-income market and in 'premium' packaging, with branding, for a higher-income market, at different price points.

The two can also be combined: through cross-subsidisation, profits from or shared costs with a high-quality version can be used to further lower prices on a lower-quality version.

WHAT ARE SOME EXAMPLES?

Cross-subsidisation

Protein Kissèe-La, Côte d'Ivoire

This processor of fortified porridge flours cross-subsidised its porridge by supplying maize grit to breweries. By using the larger margin earned when selling maize grit to the brewery, the company is able to sell the fortified porridge flour at a lower price to local consumers



MMD Kheir Zaman, Egypt

This food retailer shared costs for transport and supply chain management with a high-end supermarket to subsidise low-income-consumer-facing retail outlets.

Promise Point Limited, Nigeria

This cassava processor sold high-quality ingredients to multinational food processors and used the proceeds to subsidise a biofortified porridge flour for the local market.

Cargill, India

This major multinational company introduced its fortified oil in India at a low cost by subsidising it through profits from other products in its portfolio.

Coopérative de Transformation d'Approvisionnement et d'Écoulement de Soja (CTAE), Benin

This small cooperative targeted two different customer segments with its soybean-based product: very-low-income consumers and lower-middle-income consumers. The latter group were reached in main cities, with larger better-quality packaging that included more marketing and was sold at a larger margin.



WHAT ARE SOME EXAMPLES? (continued)

Danone, Indonesia

This multinational company marketed a fortified milk-based beverage, Milkkuat, in a premium range (a Tiger-shaped bottle) and used those margins to profitably make a basic version available at about half the price (and with a **15%** smaller margin).

Quality segmentation

Egg producer, Rwanda

This firm provided some of its lower-quality eggs (e.g., those that are cracked, discoloured, unclean, or misshapen) to employees for free, for their own consumption. It sold the remainder to members of the low-income community in which the farm is based at half the price of normal eggs.



SPAR supermarkets, South Africa

This major retailer sold lower-grade fresh vegetables (e.g., misshapen, small, or bruised ones) at discount prices through local markets in lower-income areas, including to their farmer-suppliers, while sending the higher-grade produce to higher-income urban markets to sell at normal prices.



WHAT SHOULD A FIRM CONSIDER?

The viability of cross-subsidisation strategies that segregate products across income groups can be limited in cases where there are few affluent or middle-income consumers to balance out the large number of lower-income consumers.

Under both cross-subsidisation and quality segmentation, the different prices need to be carefully set to align to the willingness to pay of each customer group for each product type, as well as to create an overall cost structure that is profitable for the firm. This may require careful customer research and financial modelling.

Producing a lower-price product can result in negative effects on the higher-price product (e.g., if the brand comes to be associated with being cheap). Some companies thus choose to produce a new brand specifically for lower-income markets, even if the formulation of the product is not majorly changed.

HOW TO DEPLOY IT?

To be able to apply these approaches, an entrepreneur must have diversity in their product quality and/or in their clients' willingness to pay. The entrepreneur can then try to match what each customer values to a product provided at a given price point by creating a menu of products and corresponding prices. The entrepreneur would need to calculate the costs entailed in providing those products at those prices and compare those to the revenues to determine what set of products and customers would make for a financially viable balance – including with cross-subsidisation, if using. It is also important to identify the different channels that will be used for selling the products to ensure they are distinct, so that a lower-priced version does not undercut a higher-priced version.

To Learn More:

Nordhagen, S, Demmler KM. 2023. How do food companies try to reach lower-income consumers, and do they succeed? Insights from a systematic review. *Global Food Security*. Doi: 10.1016/j.gfs.2023.100699.

PATH et al. (2019) Where Business and Nutrition Meet: Review of approaches and evidence on private sector engagement in nutrition. *MQSUN+ Report*.

Danse M, Klerkx L, Reintjes J, Rabbinge R, Leeuwis C. Unravelling inclusive business models for achieving food and nutrition security in BOP markets. *Global Food Security*. 2020 Mar;24:100354.

Van den Brink C, Vellema S. Making the provision of nutritious and affordable food a business: Two case studies of the intertwined processes of frugal innovation and inclusive development in Ethiopia and Benin. Rotterdam: Partnerships Resource Centre; 2018.

Kayser O, Klarsfeld L, Brossard S. 2014. *Marketing Nutrition for the Base of the Pyramid*. Paris: Hystra.

While we hope this offered useful advice, users should always consider their company's circumstances when adopting new approaches – and make sure that they are used as part of a broader viable business model. The examples cited come from a 2022 document review and may not be fully up to date.

This work was funded
by the Dutch Ministry
of Foreign Affairs



Ministry of Foreign Affairs of the
Netherlands

