

## Algramo Case: Between Social Innovation and Shared Value

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### Abstract

Traditional business models rarely solve growing economic, environmental and social challenges in society. At the same time company's success in the market and its future is not anymore determined only by its production or economic capital (investment, return on investment). Business model for creating shared value explains that social problems might be used by businesses as opportunities and social innovation is becoming one of the competitive assets to improve the socio-economic performance of businesses.

The paper focuses on one of the world's top 10 most innovative companies of 2015 in Latin America Algramo that follows the principle of shared value. The aim of the paper is to investigate the relationship between social innovation and shared value as a new responsible business model based upon a case of Algramo.

The authors of the article had an opportunity to visit Algramo – Fast Company's nominated the Most Innovative Company 2015 — in Chile in the August of 2015 in order to explore its innovative business model. One research related to social responsibility and creativity has been conducted by the authors of the article based upon the case of Algramo. This research focuses on social innovation and shared value as the successful sustainable business model in the low income market.

**Keywords:** social innovation, social problems, shared value, social entrepreneurship, sustainable business model.

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### Introduction

The number of people living in extreme poverty globally is unacceptably high. According to the most recent estimates, in 2015 9,6 % (702 million people) of the world's population lived at or below \$1.90 a day. Fewer than 44 million of the extremely poor lived in Latin America and the Caribbean, and Eastern Europe and Central Asia combined (data of the World Bank). Extreme poverty continues to afflict the world, and it requires urgent action. Along with governments, public institutions, and not-for-profit organizations, currently, companies are playing an important role in facing the world's unsolved social

problems. D. Barbien (2013) argues that the main goal of enterprises is to maximize their profits and to minimize their costs. P. Bilge *et al.* (2014) added – the main goal is succeeding in the business environment and increasing the market share. By doing this, firms do not recognize that they cause a huge amount of negative externalities with an extreme impact on the ecosystem and society (Barbien 2013). According to L. Michelini (2012) profit is the main motivation of the traditional business, whereas social motivation represents the nature of not-for-profit and public organizations, and profit and social motivation create new hybrid forms of enterprise (Michelini 2012). Currently, companies are facing a competitive, global scenario characterized by opposing dynamics. On the one hand, in developed countries, many people are willing to pay high price for certain products and services. On the other hand, the basic needs of millions of people in developing countries remain unmet because this population of potential customers is considered unable to provide compensation for products and services that would satisfy these needs. The business model in use by many large companies has changed significantly from that of a decade ago and has incorporated environmental and social aspects of performance. People living in poverty can be considered a market to target with specific products and services. Companies are reassessing their business models to create new business opportunities in which they approach the low-income market by helping solve global challenges and generating profits. Society and business had been interconnected systems since the advent of modernity (Schmitt 2013). As L. Michelini (2012) argues that the inclusive business model can offer new opportunities to a company to conduct business responsibly and, at the same time, generate economic and social value. This means that business can play a key role in eradicating poverty in society.

The research object is social innovation and shared value. The research objective is to investigate the relationship between social innovation and shared value and share the successful business case that follows the principle of responsible business. The research methods include the following: case study, systematic analysis of scientific literature and a synthesis of various approaches based on logical abstraction. Our aim was to investigate the relationship between social innovation and shared value model through a case study of the world's top 10 most innovative companies of 2015 in Latin America Algramo.

#### **Algramo case: value creation business model**

Latin America is one of the regions in the world with the highest level of income inequality and poverty (see GINI Coefficient<sup>1</sup> by World Bank in selected

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<sup>1</sup>Gini index measures the extent to which the distribution of income (or, in some cases, consumption expenditure) among individuals or households within an economy deviates from a perfectly equal distribution. Thus a Gini index of 0 represents perfect equality, while an index of 100 implies perfect inequality.

Latin America countries in Figure 3; examples of GINI coefficient in developed countries: Sweden – 27.3; in Germany – 30.1; United States – 41.1). Although the region is marked by significant improvement since 2000, currently approximately 73% of the population in Latin America survives on less than \$4 a day.

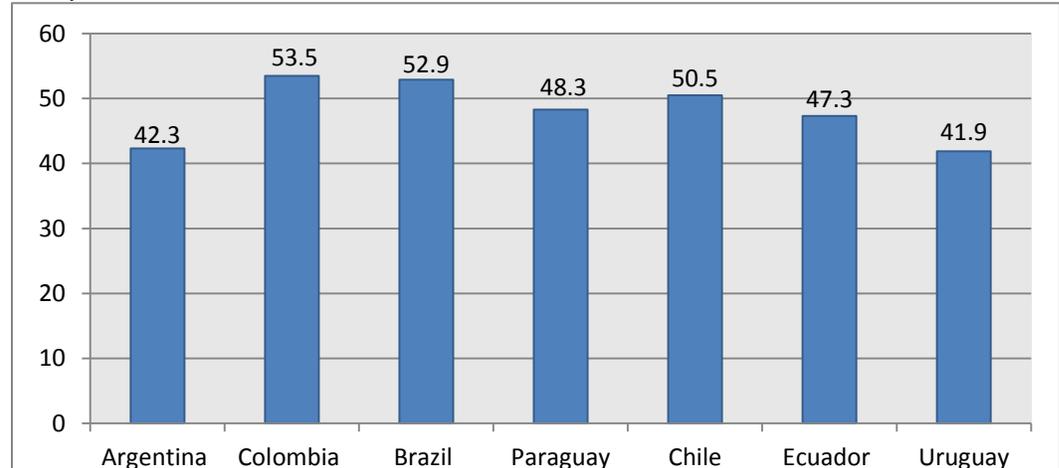


Figure 1. GINI Coefficient in 2011-2015 in selected Latin America countries, World Bank information.

While the cost of living is rising and the wages are not moving at the same speed, the most vulnerable communities in Latin America are left in the periphery, with difficult or non-existent access to basic services. This means that few people can afford to bulk buy basic essentials and the most are forced to shop in smaller, more expensive local stores that, on average, charge 30 to 50 percent more or buy at the large chains outside the community, but at a higher cost of transport and drain of resources from neighborhood-owned stores. These problems affecting families around the world every day, are a result of inequality, and can be called a “punishment for poverty” (Ashoka 2016) or a “Poverty Tax” as it was called by the founder of the company Algramo (“By the Gram”) Jose Manuel Moller. The entrepreneurs Jose Manuel Moller and his business partner Salvador Achondo used this difficult socio-economic situation as an inspiration for the business that combines opportunities to decrease income inequality and poverty in poorer regions of Chile and other Latin America’s countries and earn profits in a creative and socially responsible way. The authors of the article had an opportunity to visit Algramo – Fast Company’s Most Innovative Company 2015 — in Chile in the August of 2015 in order to explore its’ innovative business model.

In 2011, Jose Manuel Moller along with university friends (Universidad Católica, Catholic University in Santiago) moved to one of the poorest areas in Santiago (Santiago is industrial and financial center of Chile and generates 45% of the country's GDP) to experience the realities of these communities in order to understand how to help improve their circumstances (Moller 2016). For over a year and half, he lived a very humble life and faced the same problems

as the most of his neighbors: the budget was not sufficient to cover the household's basic daily needs. This realization led him and his business partner Salvador Achondo to launched Algramo in 2013. The entrepreneurs have identified that there is a large demand for the business enterprise that would deliver sustainable, high-quality essential groceries such as rice, beans and sugar at an accessible price to the poorer areas of Latin America (firstly – to the outskirts of Santiago in Chile) by selling exactly the same products as supermarket chains in smaller quantities through the vending (dispensary) machines. With resources from contest-based funds from Universidad Católica and through the government sponsored innovation contest Desafío Clave 2012 (Key Challenge 2012), he obtained the funds necessary to build the first operational machine. This business model creates alternative, non-traditional way to ensure basic needs of people with less financial and social in various local communities, socially excluded regions and countries in Latin America. Currently, with 474 stores, 56,880 benefitting people and 113,760 kilos of reduced waste, Algramo is indeed one of the best innovative businesses available in Chile now, with plans to expand to Perú, México and Brazil (Bongat 2016).

How does Algramo value creation business model work? Algramo activities focus on vending (dispensary) machines that work as normal dispenser, only instead of pouring money and leaving treats, the machine will dispense rice, lentils, chickpeas, detergent, cooking oil and other products of the basic basket into sustainable disposable plastic tubs. This reduces their costs up to 40% by saving the distribution and packaging costs. The machine is simple to use: place a reusable container on a ledge, insert coins, and wait for the product to dispense. The first purchase is free for the consumer and includes a reusable container that can be refilled in future purchases. This system encourages the use of returnable containers, where buyers may return the empty container for recycling after use. This sustainable business scheme allows reusing packaging and avoiding 2 kilos of waste per month per family. Furthermore it also contributes to reducing the carbon footprint (see Figure 2).

When launching Algramo the entrepreneurs had to be creative to find an innovative way to reach poorer communities that are usually seen as dangerous for other companies and sustain the relationships with them. Firstly, the Algramo connects with local grocers and offers the machine for free. Then the store owner is invited to the meetings to give the local owners a chance to get to know each other, share challenges, and look for solutions together instead of individually. Algramo and the owners of the small stores share the profits equally, so vendors now see each other and Algramo as partners and problem-solvers. The stronger the community group of Algramo vendors is, the more negotiating power they have with food providers to purchase in bulk from food suppliers and lower the prices for their customers.

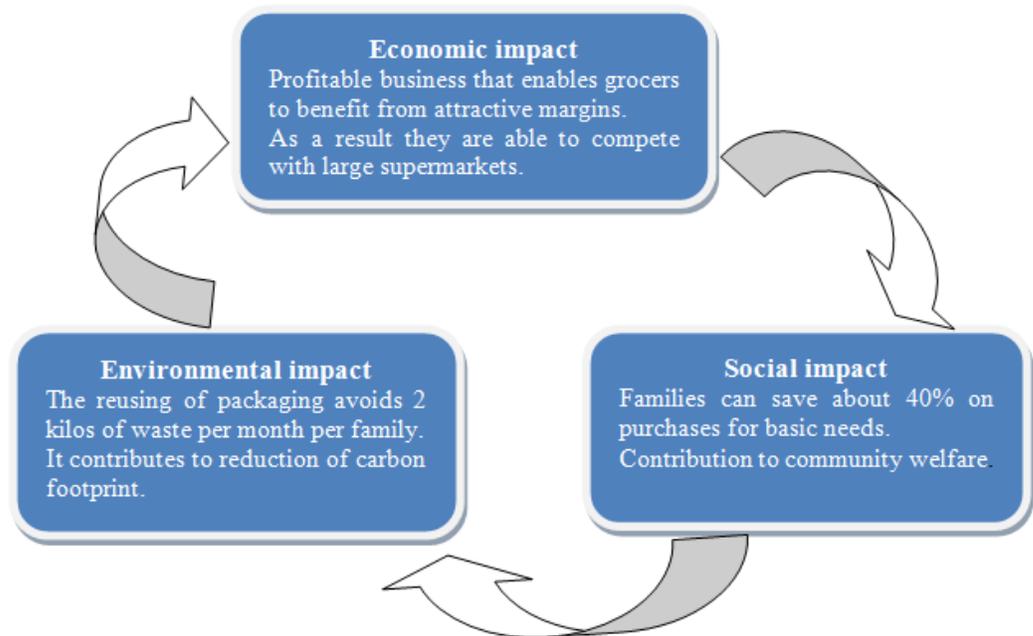


Figure 2. Economic, environmental and social impact of Algramo business model (composed by authors).

Algramo staff also helps the owners redesign the floor in order to maximize space and make it more appealing to customers and to encourage the stores to be gathering places. Algramo connects its vendors to free Wi-Fi and also provides Internet services for the customers. Algramo also owns the dispensary machines and monitors the stores' finances and inventory through the shared software. The authors of the article had an exceptional opportunity to visit one of the first shops in Santiago and speak to a store owner who is very proud to have Algramo vending machine in her small shop and see Algramo as a partner to both cut the costs, attract more consumers and build the community. Also the authors of the article had an opportunity to visit a member of a local community – the representative of the indigenous Mapuche group that accounts for nearly 10 percent of Chile's 18 million inhabitants. The woman explained that she highly appreciates the role of Algramo in her daily life and the efforts to gather local communities together.

By working through local grocery stores, Algramo helps not only to offer lower priced and more varied goods and increase the productive potential of stores, but also to lower the cost of living in these communities and restore neighbourhood stores as local gathering spots, ensuring the vitality of the vendors in the face of large supermarket chains and rehabilitating lagging neighbourhoods (see Figure 3).



Figure 3. Value creation in the Algramo business model (composed by authors).

Algramo now is certified as B Corp – a for profit business that meets rigorous standards of social and environmental performance, accountability, and transparency, and uses market tools to generate public benefit (Why B Corps Matter 2016). It works with the minister of Economy to develop a strategy for small local businesses to learn more on how to expand a business, as well as offering money and advice to certain companies. So starting with the business providing food for poorer families, currently Algramo seeks to encourage entrepreneurship around the country, increase productivity in the country and to diversify the economy by giving small companies financial and non-financial support (as a result, in 2015 start-up launches increased by 50%, with the government increasing the funds to their start-up budgets by 50% in the same year in such areas as solar energy, mining, tourism, agriculture, technology sector and healthy foods) (Banks 2016).

#### **Context of social innovation and shared value: theoretical aspects**

Literature review provides a few theoretical explanations for the analyzed case. M. Yunus *et al.* (2015) distinguish three key characteristics of business: seek to alleviate social problems, including all forms of poverty, it must be run sustainably but it should not lose money and the third – profit are reinvested in the business rather than funneled back to shareholders. M. Porter, M. Kramer (2011) have highlighted the mutual dependence that exists between corporations and society, implying that both business decisions and social policies must follow the principle of creating shared value with choices benefiting both sides. According to L. Micheline (2012) creating shared value approach means a connection between private enterprises and the public interest that produces profitable and sustainable change for both sides. J. Schmitt (2013) claims that creating shared value is based on a deeper understanding of competition and business activities, not on philanthropy. She argues that companies should rethink their products in order to configure them for the needs of the world's poor and at the same time raise profits. She understands shared value as a basic social invention in management.

According to P. Bilge *et al.* (2014) companies create value by satisfying customer needs and shareholder requirements to deliver products or services while securing shared benefits for all stakeholders: suppliers, manufacturers, distributors and customers. M. Porter, P. Kramer (2011) suggest three aspects to creating shared value:

- reconceiving products and markets;
- redefining productivity in the value chain;
- building supportive industry clusters.

Reconceiving products and markets means rethinking a company's products with regard to society's needs and the benefit or harm which is inherent to them. Considering the needs of society spurs corporate innovativeness and hence leads to new opportunities for differentiation. Redefining productivity in the value chain means societal progress and progress in the value chain is far greater than traditionally believed. Marginalized suppliers for instance may not be sustainable and productive partners, therefore new ways of collaboration shall be applied, like increasing their access to inputs, sharing technology, or providing financing. Besides this, an important stakeholder group to consider is the employees. Paying a living wage, safety measures and benefits have major influence on employee productivity. M. Porter, M. Kramer (2011) recommend companies to reduce the carbon footprint of their production and logistics by efficient energy use and shipment activities in order to save costs. Moreover, the authors advocate an efficient use of resources like water, raw materials and packaging including the consideration of recycling options throughout the value chain. Building supportive industry clusters – a company is no self-sufficient entity but depends on partnering companies and the infrastructure of its environment.

According to J. Schmitt (2013) shared value is closely linked to sustainability issues. On the company level, shared value enhances the productivity of employees and the productivity within the value chain. On the societal level, the active internalization of societal needs by businesses helps to better customize products and services to the needs of customers. By integrating society's needs into the value creation activities, shared value helps to improve direct working and living conditions along a company's supply chain (Schmitt 2013).

Problems as mass unemployment, erosion of social security systems and intensification of ecological risks cannot be tackled without implementing social innovations. L. Micheleni (2012) notes that leading companies have recently developed innovative forms of social innovation by combining three elements—the concept of shared value creation, the theory of the fortune at the bottom of the pyramid, and a corporate social entrepreneurship approach—through which they enter low-income markets by helping to solve global challenges. Following Porter and Kramer's (2011) theory, companies that have already invested or want to invest in developing countries have a choice of corporate social responsibility strategies:

- they could reduce the dangers caused by their value chain.
- they might choose a philanthropic strategy that improves the most important areas of their competitive context.
- they might choose to create a shared value approach where the social dimension of their strategy becomes part of the value proposition.

Porter and Kramer (2011) note that “the concept of shared value blurs the line between for-profit and non-profit organizations”. P. Sanchez, E. Ricart (2010) identify two types of business model configurations that can be implemented to reach the low-income market:

- isolated business models are characterized by an exploitation strategy, which leverages the firm’s own resources and capabilities for seeking efficiency;
- interactive business models are characterized by an exploration strategy, which leverages on external resources and fosters learning and innovation processes.

In the case of the isolated business model the aim of the company is to increase efficiency by reducing costs and fixing the price below the level that consumers are willing to pay. Whereas in the case of the interactive business model, the company aims to generate innovations that increase the willingness to pay by enhancing the value created for customers as well as enhancing customers’ capacity to pay (Sanchez, Ricart 2010).

In the face of the climate change, shortages of raw materials and the extensive, on-going financial and economic crisis, our society is being confronted with some profound changes. Innovation is recognized to play a central role in creating value and sustaining a competitive advantage. The main aim of the innovation must be to develop products that are new for the world, or for the market, and to be able to convince consumers that they will receive a new benefit from the product. The literature review indicates that social innovation has many definitions (Table 1).

Table 1. Definitions of Social Innovation (composed by authors).

<b>Author</b>	<b>Definition</b>
European Union Commission, 2013	Social innovation represents new responses to pressing social demands and can be defined as the development and implementation of new ideas (products, services and models) to meet social needs and create new social relationships or collaborations.
J.Schmitt, 2013	The aim of social innovation is to better solve or satisfy problems or needs than it is possible on basis of established practices.
L. Michelini, 2012	Social innovation is considered a vehicle that creates social change that is related to a better quality of life and that develops solutions and approaches to various sets of problems.
J.Howaldt, M.Schwarz, 2010	Social innovation is an intentional, result oriented new combination or new configuration of social practices.

It is obvious that social innovation describes the entire process by which new responses to social needs are developed in order to deliver better social outcomes. Innovations are not only good for society but also enhance individual's capacity to act. They are an opportunity both for the public sector and for the markets, so that the products and services better satisfy individual but also collective aspirations (EU Commission 2013).

According to L. Michelini (2012) the social value of social innovation takes on greater importance when it involves or is directed at poor people and targets the low-income market. Social innovation for the low-income market is innovation that has the central aim of improving and changing the lives and well-being of the poor. It can be referred to as an idea, process, product or service.

J. Howaldt *et al.* (2015) analyzed connection between social innovation and social entrepreneurship. Social innovation has been more simply defined as new ideas that work in meeting social goals and considered a vehicle that creates social change that is related to a better quality of life and that develops solutions and approaches to various sets of problems.

Social innovation must be at the same time sustainable, meaning that it must meet economic and environmental challenges and be economically sustainable – minimize harmful effects on the environment that are caused by its development and diffusion. L. Michelini (2012) notes that social innovation for the low-income market has the central aim of improving and changing the lives and well-being of the poor: it can be referred to as an idea, process, product or service. She notes that when we talk about social entrepreneurship, we refer to the process that invests in private people who are oriented to pursue opportunity and are satisfying unmet social needs. If this same process is applied to the business sector, we should refer to it as corporate social entrepreneurship. Social Entrepreneurship is not another form of corporate social responsibility but rather is a process for invigorating and advancing the development of corporate social responsibility (CSR) (Michelini 2012). J. Schmitt (2013) claims that current CSR approaches do not consider creating value in a way that also contributes to promoting society. On the other hand an enterprise is a complex system satisfying not only the needs of consumers but also the expectations of all stakeholders and society.

No entrepreneur or company, no matter how successful and big, can continue to hold leadership position, unless it acknowledges that modern business operates in a rapidly changing market, which creates new problems, risk and opportunities. According to M. Porter and M. Kramer (2011) the time for a new economic paradigm has arrived: *"the current approach to value creation is out-dated and companies must bring business and society back together"* (Porter, Kramer 2011).

## Conclusions

The case of Algramo demonstrates several features:

- The concept of social innovation is directly connected with a concept of sustainable development. The entrepreneurs Jose Manuel Moller and his business partner Salvador Achondo have used difficult socio-economic situation in Chile as an inspiration for their non-traditional business that combines opportunities to decrease income inequality and poverty in poorer regions of Chile and other Latin America's countries and earn profits in a sustainable way.
- Among many populations of Latin America, millions of families spend money needlessly because they buy groceries in small quantities. For profit businesses as Algramo that meet rigorous standards of social and environmental performance, accountability, and transparency – show that new business models can combine principles of shared value and social innovation and provide solutions that bet on smart shopping, reduced waste, and revolutionize retail sales by saving the distribution and packaging costs.
- Shared value is closely linked to sustainability issues. On the company level, shared value enhances the productivity of employees and the productivity within the value chain. On the societal level, the active internalization of societal needs by businesses helps to better customize products and services to the needs of customers. In a case of Algramo sustainable, high-quality, lower priced and more varied goods are delivered in smaller quantities through the vending machines to ensure basic needs of poorer communities that are usually seen as dangerous for other companies.
- Social innovation is a new social practice, the development and implementation of new ideas (products, services and models) to meet social needs and create new social relationships. Social innovation refers to new ideas that work in meeting social goals. By working through local grocery stores, Algramo increases the productive potential of stores, lowers the cost of living in these communities and restores neighbourhood stores as local gathering spots. Cooperation between Algramo and the vendors results in equally shared profits, productive partnerships and efficient problem-solving of local communities.

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