

THE INCLUSION ILLUSION: FIRMS' INVESTMENT STRATEGIES AND THEIR COMMITMENT TO SERVE THE POOR¹

ABSTRACT

The favelas of Rio de Janeiro, Brazil, are the archetype of settings where institutions have failed. This paper examines how these failures influence e-commerce firms' strategy regarding delivery prices and availability of the goods sold online. The paper uses a mixed-method approach, combining a regression discontinuity design (RDDs) with ethnographic techniques, to examine delivery prices charged by e-commerce firms immediately inside and outside the open boundaries of Brazilian favelas. Results show that, on average, firms charge favela consumers more than those residing outside favelas, creating an "inclusion illusion" of online markets. Heterogeneity also arises as some firms charge consumers within favelas significantly less than others. Firms that invest more in dynamic capabilities such as internal culture and reputation towards stakeholders are more inclusive of the poor. This paper seeks to contribute to research on inclusive innovation by highlighting how a firm's strategy can moderate the impact of institutional failures.

SUMMARY

To what extent do e-commerce firms' investments in dynamic capabilities moderate institutional failures? This study aims to analyze how e-commerce firms investment in dynamic capabilities, such as inclusive culture and reputation with employees, affect their commercial strategies towards disenfranchised individuals from Brazilian favelas. "*Favela*" is the Brazilian Portuguese term for an unregulated urban agglomeration whose inhabitants have a low income per capita (i.e., urban slum). According to the 2030 United Nations Agenda for Sustainable Development, problems such as poverty, inequality, and sustainable cities emerge as crucial aspects for global socio-economic development. Moreover, recent literature evidenced the importance of management on pushing forward this agenda by tackling societal grand challenges (George, Howard-Grenville, Joshi, & Tihanyi, 2016; McGahan, 2018). A conventional way for-profit organizations tackle social problems is through the application of technology to improve commercial outcomes. In this sense, many for-profit organizations are committing to the so-called "inclusive innovation," i.e., the development of new ideas and solutions that enhance social and economic wellbeing for poorer members of society. For example, firms such as Alibaba in China and ITC in India have developed technological solutions to empower marginalized communities in rural areas, through the use of online platforms (Leong, Pan, Newell, & Cui, 2016; Prahalad & Hammond, 2002; Prahalad, 2006).

Despite these inspiring examples, there are concerns about the extent to which technology alone can actually foster social inclusion. Scholars have shown that even though big data analytics can increase e-commerce firm profitability, it might do so through new forms of price discrimination based on consumer characteristics, such as geographical location and demographics (Acquisti & Varian, 2004; Chen, Chiang, & Storey, 2012; Kshetri, 2014). For example, in the United States, Amazon has been accused of delivery discrimination towards African-American and Hispanic neighborhoods (Ingold & Soper, 2016). Technological solutions without firms' commitment to pushing forward an inclusive socioeconomic agenda, can simply increase e-commerce firms' ability to screen out low-income consumer locations and price discriminate them based on this information. Nevertheless, technology

¹ The reference list is omitted in this document aiming to attend space limitations. Full reference list can be found in the manuscript file.

application by e-commerce firms may lead to higher social inclusion, if firms combine its use with investments in inclusive capabilities.

The conventional view drawing on institutional theory asserts that institutionally flawed environments allegedly increase the transaction costs of serving consumers by hampering the efficiency of the market mechanism (Dutt et al., 2016; Khanna & Palepu, 2010; North, 1990). The perceived superior transaction cost induces firms to charge higher prices or not to serve these consumers at all. Nevertheless, empirical evidence shows that some firms can overcome the institutional failures particularly in low-income markets through the development of specialized resources and capabilities, such as reputations, on how to serve marginalized consumers (Gao, Zuzul, Jones, & Khanna, 2017; Kogut & Zander, 1996; Pless & Maak, 2004; Teece, 1986). For example, Casas Bahia, a big retail chain in Brazil, developed several management features as well as a culture of serving poor customers according to their resource constraints (Prahalad, 2006, pp. 119–120). It follows that for-profit organizations, in particular, e-commerce firms, might combine technological tools with investment in capabilities, such as culture and reputation, which lead them to treat poor consumers inclusively. To this end, firms can focus on the “long-run” performance, optimize their pricing decisions to include low-income consumers in their client pool, and consequently, achieve a competitive advantage in these flawed institutional markets. Hence, the conventional institutional view can be enriched if we consider how firms’ investment decisions on dynamic capabilities affect their strategy towards low-income consumers.

This study examines how e-commerce firms investment decisions on specific capabilities can increase their inclusiveness towards favelas consumers. More specifically, I theorize how inclusive e-commerce firms, i.e., firms whose innovations benefit the disenfranchised (George, McGahan, & Prabhu, 2012, p. 661), overcome institutional failures and differ in their treatment of marginalized consumers from non-inclusive firms. I test these predictions by examining e-commerce firms’ transaction decline rates and delivery price decisions. I compare these rates/decisions towards different types of consumers: those immediately inside and outside the open boundaries of 21 Brazilian favelas. I employ a mixed-methods approach (Kaplan, 2016; Small, 2011) consisting of a quantitative component based on econometric models and a qualitative component based on ethnographic techniques.

Results indicate that e-commerce firms appear to use the information contained in big data as a way to evaluate the institutional failure of consumers from different socio-economic backgrounds based on their location. Findings show that once e-commerce firms know whether a customer is inside or outside a favela, they decide to decline or not a transaction and set delivery prices accordingly. In particular, they are more likely to decline transactions, and charge higher prices to favela residents compared to residents outside favelas. Moreover, results show that the closer a customer lives to the center of a favela, the higher the delivery price. For example, getting 500 meters deeper inside the favela from the border is associated with a 50% higher delivery price. This result reinforces the conventional view of institutional theories and supports the idea of an “inclusion illusion” regarding firms’ technology use in transactions with low-income customers, i.e., better data about the location of consumers can have negative effects on the inclusion of low-income consumers in regular market transactions. Nevertheless, the study shows that in contrast to the conventional view, firms are heterogeneous in their inclusion strategies towards the favela populations. In spite of the institutional failures, some firms invest in inclusive capabilities such as culture and reputation, which enables them to commit to social inclusion, by charging disenfranchised consumers significantly less than their competitors.

This paper contributes to the inclusive innovation literature in strategic management by theorizing how e-commerce firms might foster or detract from social inclusion through their investment in dynamic capabilities. The paper also advances the empirical tests of inclusive innovation strategies using a mixed-method approach which deepens the understanding of the phenomenon.