Microfranchises as a Solution to World Poverty

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Fast food restaurant chains, icons of profligate Western consumer culture, epitomize a business model that may be a key solution to the daunting challenge of global poverty.

Poverty as Slavery

Endemic poverty, afflicting billions of people on earth today, is a form of slavery caused by exploitation enforced through corrupt institutions. Physical slavery is defined as people:

- Trapped
- Controlled by violence
- Paid nothing
- Exploited for labor

Structural poverty, including debt or wage slavery, can be defined as people:

- Trapped
- Controlled by oligarchs, slumlords and corrupt intermediaries
- Paid very little
- Exploited for labor

A Sordid Tale

The president of a marginally functional state skims cash from national enterprises. Ministers extort kickbacks to approve government contracts. Bureaucrats entangle every transaction in mountains of red tape, expecting payments to expedite paperwork. Doctors and nurses steal drugs and sell them on the black market to supplement meager incomes. Policemen impound vehicles if hapless drivers fail to bribe them. Prospective educators pay large sums to secure precious teaching certificates. Postal employees pilfer mail. People disregard traffic signals and crowd in lines, occasionally triggering deadly stampedes. Tax evasion is a national pastime. Alcoholism and other forms of substance abuse are pandemic. Domestic help and common laborers are routinely ill-treated because they have no effective recourse, legal or otherwise. Parents send their children into the streets to peddle or beg, abusing the youngsters if they return home without their daily quota of money. Property crime is so rampant that people padlock spare tires to their cars and surround their homes with high walls topped by broken glass and razor wire.

The common denominators: ego-centricity, exploitation and acutely short-term orientations. Under such mercenary conditions, public trust, large-scale co-operation and nurturing institutions are rare. In this environment, debt relief, development aid and favorable trade rules do little to solve poverty. These macroeconomic structural adjustments generally strengthen the hand of the predatory elites and strongmen who are the root cause of poverty in the first place.

Enterprise is the Solution

Enlightened enterprise is the solution to poverty. Five path-breaking concepts demonstrate the enormous power and versatility of responsible capitalism:

- Grameen Bank founder Muhammad Yunus (Banker to the Poor, 1998) taught us that people in poverty are creditworthy.

- Peruvian economist Hernando de Soto (<u>The Mystery of Capital, 2000</u>) taught us that people in poor areas have accumulated substantial assets which can be leveraged to create capital within appropriate legal frameworks.
- Harvard professor Clayton M. Christensen and Cornell professor Stuart L. Hart (<u>The Great Leap, 2002</u>) taught us that many disruptive innovations are best introduced in low-income markets.
- Michigan professor C.K. Prahalad (<u>The Fortune at the Bottom of the Pyramid, 2004</u>) taught us that large viable markets exist among the people at the bottom of the income pyramid (BOP).
- Stuart L. Hart (<u>Capitalism as the Crossroads, 2005</u>) taught us that environmentally, socially, and financially sustainable enterprises can perform well in both wealthy and emerging markets.

These works establish the theoretical basis for definitive enterprise solutions to world poverty. What we need now is an implementation vehicle that can successfully deploy each of these important concepts on a global scale. Experience is demonstrating that one of the most effective deployment vehicles is the franchise business model.

The problem with enterprise is that it favors the rich, the connected, the educated and the strong. Hierarchical business models concentrate wealth and power. Many firms with substantial wherewithal seldom reach the villages and slums where the world's poor languish. Business climate improvements through transparency, anti-corruption, property protection, formalization, and rule of law initiatives are tough to implement without major social upheaval if not bloodshed. All too often, advances achieved with one administration evaporate when new political leadership takes office. Cross-sector partnerships are often unwieldy. Holly Wise, director of the Global Development Alliance, posed a brilliant question in San Francisco at the 2004 World Resources Institute (WRI) conference "Eradicating Poverty Through Profits – Making Business Work for the Poor." She said, "We don't have the right structures to do this thing, yet. Alliances between multi-national corporations (MNCs), non-governmental organizations (NGOs), and governments are messy and noisy. Are there solutions in terms of wiring? Network models?"

Network Business Models

The answer to Wise's question is a resounding yes. Network models are supplanting traditional hierarchies at a rapid pace. Broadcasting has become narrowcasting across hundreds of cable channels. Behemoth telephone monopolies have given way to nimble wireless carriers. Encyclopaedia Britannica is fading as we rush headlong into a new Wikipedia world. Outsourcing not only connects Chicago with Bangalore. Increasingly, it now connects Bangalore with rural Tamil Nadu. The Internet has leveled the global playing field to such an extent that New York Times columnist Thomas Friedman titled his latest book The World is Flat. Many flourishing pro-poor enterprises (Grameen Village Phone, Honey Care Africa, Cemex Patrimonio Hoy, Amul, Hindustan Lever) employ network business models that are quite different from conventional corporate command and control hierarchies.

Franchising as a Network Business Model

Insight #1: **The most successful network business model on earth is franchising.**

Popularized in modern times by Isaac Singer's sewing machine distributors, Western Union's telegraph and remittance agents, Henry Ford's automobile dealers, and Ray Kroc's restaurateurs, the franchise model comes in business-in-a-box, sales representative, co-operative, product, and business format varieties. A franchise is a symbiotic relationship between local entrepreneurs and an enabling institution. Franchisors and franchisees jointly own and co-develop the rights to a brand, technology or some other form of intellectual property. Franchises are businesses that have been systematized for replication. Most franchise networks create a long-term mentoring relationship between and among the franchisor and the various franchisees. Scarcely noticed 50 years ago, franchising now accounts for 10 – 25% of gross domestic product (GDP) in most Organization for Economic Co-operation and Development (OECD) countries. A new franchised business opens somewhere in the United States (US) every 8 minutes. Subway, one of the global market leaders, has 23,000 locations in 77 countries. Averaging 40% annual growth on the Iberian Peninsula, the franchise business model is one of the major reasons Spain has risen from economic weakness to become a global player in the last 20 years. There is a direct relationship between the degree of penetration the franchise business model has achieved in a given country and the level of economic prosperity in that country. In the following chart, the per capita GDP numbers come from the current Central Intelligence Agency (CIA) World Factbook and the number of operating franchise systems comes from national franchise association publications and communication with in-country franchisors.

Country	Per-Capita GDP	Franchise Systems in Operation
US	$41,800	15,000
Spain	25,100	2,500
Brazil	8,500	1,200
Philippines	5,100	750
Ecuador	3,900	60
Malawi	600	5

Franchising is democratic capitalism. It distributes ownership, wealth and power widely within a target demographic. Brigham Young University (BYU) entrepreneur in residence, Stephen W. Gibson, observes that franchises "remove the creative burden" from prospective enterprisers. Vibrant franchise networks are now found in agriculture, extractive industry, construction, manufacturing, distribution, retail, hospitality, professional service, financial service, business service and personal service niches. The refined methodology behind successful franchise operating systems helps the model sustain an enviable global reputation for low rates of business failure.

Franchising as a Solution to Poverty

Insight #2: **The franchise business model demonstrates remarkable strengths as a poverty intervention.**

Economists and development professionals decry the "missing middle." Many developing countries have large (often extractive) industries at the top of their economies and a cacophony of micro enterprises at the bottom, with a severe dearth of small and medium-sized enterprises (SMEs) in-between. SMEs matter because, as Mark Malloch Brown, formerly head of the United Nations Development Programme (UNDP), has said, "most of the real economic development takes place in the middle." The franchise business model is uniquely adept at creating large numbers of locally-owned, successful SMEs. Approximately 25% of the SMEs in Brazil, for example, are now franchises.

People living in poverty yearn for jobs, but most have no choice other than high risk, low return self-employment in the informal sector. In developed economies, the relatively few naturally-gifted entrepreneurs create businesses which employ non-enterprisers. In the developing world, the formal economy creates so few jobs that most people are forced into low-productivity, copycat micro enterprises that rarely employ anyone other than the struggling owner/operator. Franchises almost always generate higher levels of employment than individually-owned businesses. This job creation effect is one reason the governments of the Philippines and South Africa actively promote franchising.

Prosperity results when a preponderance of transactions in an economy are win/win. Consistently positive feedback eventually results in trust and optimism which fuel the virtuous business cycles that create economic growth. The developing world is awash in exploitative win/lose transactions that breed mistrust and pessimism, thus perpetuating poverty. Enough win/lose transactions eventually create a cynical paranoia that spawns lose/lose transactions. Civil war, suicide bombings, road blockades, and vandalism, for example, are lose/lose transactions. Tiny civil wars are going on every day between individuals and factions all over the developing world. Franchises by their very nature require a co-operative win/win/win relationship between the franchisor, the franchisee and customers. Franchises supplying a critical social good such as essential medicines, clean water or renewable energy technology can even create a quadruple win.

General respect for the rule of law provides a framework for successful enterprise in wealthy countries. In the developing world, the rule of law is frequently irrelevant or highly compromised, particularly in the informal economy where most low-income people live and work. A franchise system establishes a surrogate rule of law that provides the framework for business success. Franchisees who disregard the rules risk losing their investment, so it is in their self-interest to be "law-abiding citizens" within their franchise community. Franchise networks are typically formal, registered businesses whose affiliates benefit immediately from the parent organization's legal status.

Financing SMEs is a challenge in most developing countries. Franchise systems frequently offer creative financing packages to prospective franchisees. The Wizard Schools in Brazil, for instance, self-finance new locations. Other franchisors act as loan guarantors or establish cross-selling relationships with local financial institutions. In Mexico, some franchise brands have such solid reputations that lenders consider their loans collateralized, just as they do in the US. If an individual franchisee fails, the franchisor will often take over that location temporarily as a company store until a new franchisee can be recruited. This operational continuity, called “conversion” in franchise parlance, secures creditors and reduces lending risk. Many franchise systems have such consistent performance that equity funding is available in addition to debt financing. Private capitalists exist in India, for example, who will joint venture a new franchise location as an owner/investor in partnership with the franchisee owner/operator.

Far too many regions and countries in the developing world suffer low or even negative rates of real economic growth. Franchises can inject life into stagnant economies. Franchising is growing much faster than the underlying economy in most countries on earth. In Mexico, recent annual economic growth has been in the 3 – 4 % range while the franchise economy has grown by 15 – 20 %. In India, where economic growth has averaged 6 – 8%, franchising has been growing at a rate of 20 – 30 %.

C.K. Prahalad eloquently describes the “poverty penalty,” the fact that many goods and services cost much more in poor areas than they do in more affluent neighborhoods across town. Franchise systems typically implement rational pricing across a region or even a country. Franchises tend to maximize network rather than individual location revenues. Price gouging in any one location is fundamentally incompatible with the national brand reputation franchise owners seek.

Education builds capacity, which is why development aid programs have focused on education for decades. Education does not necessarily create employment, though, as the legions of highly trained taxi drivers in Lima or Manila can attest. Franchise systems offer a very effective type of education: hands-on vocational training that is directly relevant to a franchisee's livelihood. Most franchises offer apprenticeship opportunities and access to life-long mentoring.

NGOs and social entrepreneurs (SEs) are highly creative. Most of their projects, though, never scale-up beyond the level C.K. Prahalad calls "a contained experiment." Franchising, on the other hand, has replication in its genes. If entrepreneurs in the citizen's sector built franchise systems rather than social programs, they could magnify their potential impact many times over by creating sustainable enterprises.

Microfranchising

Insight #3: **The franchise model works effectively, even with very small businesses**.

The nascent Microfranchise social movement is quickly learning how to adapt the proven franchise business model to the stark reality on the ground in the developing world. A Microfranchise is generally defined as a structured business available to and within reach of BOP enterprisers. To fit the definition, total start-up costs for a Microfranchise cannot exceed 3 times per-capita GDP in a country. This means that a Microfranchise business opportunity in Kenya cannot cost more than $3,000, while a roughly comparable business in Brazil may cost as much as $25,000.

Hernando de Soto describes the "bell jar" that isolates and protects the formal economy in a developing country, while keeping out the raucous informal economy and its marginalized masses. Most high-priced foreign franchises in the developing world have historically operated within the bell jar. Microfranchises are demonstrating that franchise networks can flourish in low-income areas far afield from wealthy urban centers. Just as ubiquitous franchises permeate nearly every nook and cranny of the US, Canada and Australia, Microfranchises are penetrating slums and villages all over the developing world.

Microfinance institutions (MFIs) eventually reach a point of diminishing returns in a community where more credit does not necessarily result in more economic growth. In Bolivia, for example, the micro credit market is essentially saturated, yet Bolivia remains the poorest country in South America. Leading MFIs have begun offering proven Microfranchised business formats in addition to financial services. Grameen has been doing this for many years, and now BRAC, SKS, FINCA, Freedom from Hunger, and others are getting on board. Informed observers like Don Terry, manager of The Multilateral Investment Fund (MIF), are calling Microfranchising "the next generation of microfinance."

Multi-national corporations (MNCs) and large domestic companies (DCs) often struggle to craft a coherent BOP strategy that leverages their core business competencies without disrupting existing markets. Clayton M. Christensen notes that it is "a very unnatural act" for MNCs to venture down market. Microfranchising is proving to be a highly appropriate way for many MNCs to engage the BOP as customers, suppliers, and business partners. The franchise business model is well-known and thoroughly proven.

Most MNCs already utilize it somewhere in their global value chain. Microfranchised networks of small, locally-owned businesses in emerging markets can complement traditional business units in mature markets. Shell, Unilever, Microsoft, Holcim and Vodafone, for example, are all experimenting with this approach.

Microfranchise Catalog

Consider the following extant Microfranchises. Some of these enterprises have company stores, traditional franchises, and Microfranchises operating together in their networks. In some cases, the Microfranchise is a unique brand separate from the larger traditional franchise. The acronym denotes the current organizational type of the original founding institution. The list is in descending order by number of Microfranchisees.

1. Amul, India, 10,000 co-operatives and 8,000,000 dairies. MNC
2. Avon, Brazil and many other countries, 750,000 local sales agents. MNC
3. Natura, Brazil, 400,000 local sales agents. DC
4. Grameen Village Phone, Bangladesh and 2 other countries, 200,000 phone ladies. MFI
5. Unilever, Vietnam and 3 other countries, 145,000 sales agents. MNC
6. Lijjat, India and many other countries, 25,000 producers. Indigenous franchisor (IF)
7. Kumon Schools, Japan and 45 other countries, 23,000 tutors. MNC
8. Paleterias La Michoacana, Mexico and many other countries, 16,000 frozen confectioners. IF
9. Honey Care Africa, Kenya and 2 other countries, 7,800 beekeepers. Social enterprise (SE)

10. JaniKing, US and 50 other countries, 7,500 cleaning contractors. MNC
11. Tropical Sno, US and 40 other countries, 5,500 flavored ice vendors. MNC
12. Vodacom Phone Centers, South Africa, 5,000 phone centers. MNC
13. Grameeen Uddog, Bangladesh, 4,500 textile weavers. MFI
14. Arvind Mills, Ruff 'n Tuff Jeans, India, 4,000 tailors. DC
15. Farmacias de Similares, Mexico and 8 other countries, 3,400 pharmacies. DC
16. Desk to Desk Delivery Service, India, 3,000 couriers. DC
17. NLogue, India, 2,700 information, communication and entertainment technology (ICET) centers. IF
18. ES Coffee, Ecuador and 3 other countries, 2,500 coffee producers. IF
19. Aptech Schools, India and 33 other countries, 2,500 computer based training (CBT) centers. MNC
20. O Boticario, Brazil, 2,400 cosmetics stores. IF
21. Grameen egg ladies, Bangladesh, 2,000 egg producers. MFI
22. Coca-Cola, South Africa, 1,850 beverage vendors. MNC
23. Wizard, ALPS, Brazil, 1,500 language schools. IF
24. Shell Breathing Space, Guatemala and 8 other countries, 1,000 stove dealers. MNC
25. Shell Solar, Thailand and 4 other countries, 900 solar installers and technicians. MNC
26. Amanco Irrigation, Costa Rica and 5 other countries, 800 product reps. MNC
27. Gamarra Merchants Association, Peru, 750 merchants. DC
28. Grameen Motsho Fish Farms, Bangladesh, 600 ponds. MFI

29. Holanda, Mexico, 600 ice cream restaurants. IF
30. Drishte, India, 550 ICET centers. SE
31. ForesTrade Spices, Indonesia, 500 spice gatherers. SE
32. Play Pumps, South Africa and 3 other countries, 500 water pumps. SE
33. Cemex Patrimonio Hoy, Mexico and 3 other countries, 500 local promoters serving 120,000 construction jobsites. MNC
34. Unilever Annapurna Salt, Ghana and 1 other country, 8 salt plants and 400 local sales agents. MNC
35. Nacho King, Philippines, 400 snack food vendors. IF
36. Hawaiian Paradise, Mexico, 367 flavored ice vendors. IF
37. Farmacias Comunitarias, Cruz Azul, Ecuador, 310 pharmacies. DC
38. Julies's Bake Shops, Philippines and 1 other country, 300 bakeries. IF
39. Janini Medical, India, 260 clinics. IF
40. Pride Africa, Kenya and 4 other countries, 250 micro finance agents. MFI
41. Blaze Flash Delivery Service, India, 225 couriers. DC
42. Scojo Vision, El Salvador and 3 other countries, 200 vision entrepreneurs. SE
43. Reyes Barbers, Philippines and 1 other country, 200 barber shops. IF
44. UMU, Uganda, 125 micro finance agents. MFI
45. Magitek, Tanzania and 2 other countries, 120 village water systems. SE
46. Dormimundo, Mexico, 120 sleep centers. DC
47. UV Water, Philippines and 2 other countries, 100 village water systems. SE
48. Porta Newcell, Ecuador, 100 cell phone stores. IF
49. Ingles Individual, Mexico, 70 language tutors. IF

50. Health Stores, Kenya, 56 pharmacies. SE

51. Super 1, Colombia, 50 car care technicians. IF

52. Pañaleras Pototin, Ecuador, 45 diaper stores. IF

53. Grameen Shakti, Bangladesh, 40 solar installers and technicians. MFI

54. Holcim Cessa, El Salvador, 35 building materials dealers. MNC

55. Yogurt Persa, Yogurt Tito, Ecuador, 35 restaurants. IF

56. Cellular City, Philippines, 33 cell phone stores. IF

57. Ferns 'n Petals, India, 32 floral shops. IF

58. Temasol, Morocco, 31 solar installers, technicians. SE

59. Unilever, Indonesia, 25 soybean farmers. MNC

60. GlensCare Africa, Tanzania, 25 transportation agents. SE

61. HP Photo, India, 25 village photographers. MNC

62. Casa por Casa, Mexico, 18 advertising agents. IF

63. Valet Taxis, Peru, 10 owner operators. DC

64. Vodafone M-Pesa, Kenya, 10 financial service agents. MNC

65. One Roof, Mexico and 1 other country, 8 community information centers. SE

66. Cebicherias Chiqui, Peru, 5 lunch stands. SE

67. Maharlika Drug Stores, Philippines, 3 pharmacies. SE

68. Ink Patrol, Philippines, 1 ink refilling station. SE

This list is representative, but not exhaustive. There are at least 200 Microfranchise networks operating successfully in the developing world today and the model is growing rapidly. The sample suggests several significant conclusions:

- Microfranchises are being successfully developed by 5 different constituencies: multi-national corporations, domestic companies, indigenous franchisors, micro finance institutions, and NGOs/social enterprises.
- Microfranchises are operating in dozens of developing countries.
- Microfranchises have been deployed in at least 18 different industries.
- Microfranchising encompasses at least 15 discrete business models.
- Well-managed Microfranchise networks can grow rapidly to become very large. The normalized mean number of franchise locations per network in the sample is 7,675 (normalization disregards the 3 largest and the 3 smallest enterprises). The median number of franchise locations is 400.

Call to Action

Microfranchising is still a novel concept in many circles. It can become "the next big thing" in international economic development if political will develops and key constituencies advance appropriate policy agendas:

- Microfinance institutions and NGOs/social enterprises should consider offering Microfranchised business opportunities to their clients. A proven methodology is to become a master franchisee or area developer for one or more reputable brands.
- Indigenous franchisors should realize that their model works outside the bell jar and create Microfranchise brands to go down market.
- Domestic companies and multi-national corporations should note that many businesses successfully engaging the BOP are not convoluted cross-

sector partnerships. Viable Microfranchise networks that leverage core lines of business are often fairly straightforward commercial implementations of a familiar business model.

- The development community should wean itself away from aid models in favor of genuine enterprise sustainability through pervasive local ownership.
- Governments in the developing world should create franchise-friendly business climates. Franchises from abroad are highly desirable forms of foreign direct investment (FDI) that introduce rare and precious franchise know-how into emerging markets. Problematic government policies include limits or taxes on repatriated royalties and attempts to enact a comprehensive franchise law prematurely before the indigenous franchise economy has gone through a period of florid innovation.

A Success Story

In May 2005, Leonidas Villagrán, president of the Ecuadorian Franchise Association, first heard about Microfranchises. He is a consultant to Yogurt Persa, a local chain that in 9 years had grown to 20 franchised restaurants in Guayaquil and Quito. A typical Yogurt Persa location requires $50,000 to $100,000 of start-up capital. Yogurt Persa growth had stalled. There are not that many prime locations left in Ecuador’s large cities and only so many Ecuadorians can afford to invest $50,000 to $100,000 in a business. Villagrán helped Yogurt Persa create a new brand, Yogurt Tito, as a Microfranchise with a start-up capital requirement under $10,000. The new concept was an overnight success. 15 Yogurt Tito locations are currently operating and the company expects to have 50 by the end of 2006. Yogurt Tito restaurants are flourishing in slum areas that would never support a much larger Yogurt Persa. Some of the initial Microfranchisees who had to take on partners to fund their ventures recouped their investment in less than 6 months. Leveraging its parent's infrastructure, Yogurt Tito has become Yogurt Persa's growth engine. This disruptive innovation comes not from sophisticated technology, but through the intelligent application of a common-sense business model in under-served markets.

Microfranchises as Liberators

We end where we began, with billions of our disenfranchised fellow humans suffering silently the mind-numbing, daily indignities of institutional poverty. Nobel laureate Muhammad Yunus calls them "bonsai people," stunted by their environment, who will die without ever knowing what they were capable of. Nobel laureate Amartya Sen calls them victims of "unfreedom." These huddled masses are impoverished slaves, yearning to breathe free. The English word *franchise* comes from the old French *franchir* which meant to liberate or set free. Proliferating successful, locally-owned, small businesses as Microfranchises can empower hundreds of millions of our brothers and sisters to lift themselves up out of poverty. This business model based on inclusive, mutually beneficial reciprocity can help incite commercial revolutions around the globe.

If bankers, investors, CEOs, development professionals, and policymakers will embrace this robust business model, Microfranchising can become one of the primary vehicles the world needs to achieve the Millennium Development Goals (MDGs) by 2015.

Note: The orthography of the word "Microfranchise" and its derivations as used in this paper follows the convention established by the Microfranchise Development Initiative (MDFI), Center for Economic Self-Reliance (CESR), Marriott School of Management, BYU. For an in-depth look at the franchise business model and its implementation as a poverty intervention, see Kirk Magleby's 131 page book entitled *Microfranchises as a Solution to Global Poverty* published in 2006 by Ascend, a Humanitarian Alliance www.ascendalliance.org/page.php?microfranchises.

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