From Access to Finance to Access to Franchise

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This paper examines markets for the poor in developing countries from the perspective of microenterpreneurs and other members of the working poor consumers and corporations and NGOs. The paper shows that microfranchising can be a valuable tool in addressing the challenges facing these market actors and that MFIs can have a distinct role in facilitating microfranchising arrangements. Two case studies present models used successfully by an NGO and a multi-national corporation to scale operations rapidly in remote locations.

Examining Markets for the Poor

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A microfranchise is a small business operated according to pre-established procedures that are simple and replicable.[2] Similar to microfinance, microfranchising brings a streamlined model of a common business structure in the developed world to entrepreneurs in the developing world. Whereas microfinance provides access to capital and saving, microfranchising provides access to global brands' business processes, products and services.

Microfranchising can serve the interests of multiple stakeholders in or trying to enter developing markets, and especially rural developing markets. For franchisors, which include corporations and non-governmental organizations (NGOs), the basic motives behind microfranchising are the same as that of franchising: rapid expansion, highly incentivized representatives, and brand control. For the working poor, linking with a large, sophisticated franchisor can be a competitive advantage leading to increased household income. To connect potential microfranchisees, franchisors have partnered with NGOs and microfinance institutions (MFIs) seeking to further their social impact while adding a revenue stream as paid intermediaries.

This paper examines markets for the poor in developing countries from the perspective of (I) microenterpreneurs and other members of the working poor (II) consumers and (III) corporations and NGOs. The paper shows that (IV) microfranchising can be a valuable tool in addressing the challenges facing these market actors and that (V) MFIs can have a distinct role in facilitating microfranchising arrangements. Two case studies illustrate several of the paper's themes.

I. The Working Poor: Barriers to Growth and Productivity

Many of the poor work in microenterprises, which are small businesses of about nine employees or less. There are estimated to be more than 1 billion microenterprises in the world.[3] In general, the owners/operators of microfranchises, have had previous experience working in microenterprises. Their experiences, however, are often characterized by "self-exploitation": long hours with little financial reward. The introduction of financial services through MFIs has moderately improved their income in many cases,[4] but microfinance has done little to create jobs for those lacking entrepreneurial talents or opportunities.[5] The median microenterprise is a sole proprietorship with no staff on payroll. [6]

While microfinance has lessened capital constraints, microenterprises still face numerous obstacles to sustained growth and wealth creation. Low pricing power and relatively high costs lead to thin margins for microenterprises. Microenterprises operate in saturated markets because they typically require little capital or skills to start. Their goods and services

[2] "What is Microfranchising?" 2008
[3] "A Microenterprise Training Guide for Peace Corps Volunteers" 2007
[4] For a survey of evaluations, see Goldberg 2005
[5] Khandker, Samad and Khan (1998) find that the incursion of new capital in villages in Bangladesh increased the profitably of self-operated enterprises, but not to the point that the micro-enterprises added wage laborers. Bracken et al (2006, p.2) find that financing helps microenterprises grow until they have reached the maximum return that can be achieved through the familial labor force.
[6] Karnani 2007, pg. 30

are often undifferentiated and competition is based on price.[7] On the cost side, because of their relatively small size, microenterprises may face higher per unit outlays than larger businesses. Numerous and fragmented, microenterprises have little negotiating power with their more concentrated and better organized suppliers.

The informal legal status of most microenterprises presents further obstacles. First, lack of legal status can be a hindrance in obtaining credit, insurance and access to government programs. Second, legal informality diminishes the incentive to invest in one's business. Without secure property rights, equity built up over the years is always in jeopardy. Police and government officials can close operations at any time and demand bribes. Third, the absence of a formal contract system prevents owners from acquiring new firms or maintaining equity in their own businesses once they cease personally operating them. Owners of microenterprises understand that it is irrational to put money into a business that may be extorted, forced to move, or declared illegal at any time.[8]

On the other hand, excessive requirements to legally establish and run a business often make it irrational to join the formal sector. Legal rules in some countries make it unrealistic to expect that entrepreneurs will have the time, legal expertise, or money to escape the underground economy. For example, according to the World Bank's "Doing Business 2010" report, starting a formal business in Guinea-Bissau requires 16 procedures, 213 days and a cost of 323% of income per capita.[9] Already faced with an unfavorable competitive environment, these barriers to formalization reinforce microentrepreneurs' vulnerable economic status.

II. Consumers: Paying the Poverty Penalty

The competitive pressures on microentrepreneurs do not necessarily result in greater consumer value. In fact, some evidence indicates that the poor suffer a "poverty penalty". The extra cost incurred in distributing goods to hard to reach areas, where the poor often live, is absorbed by end consumers in the form of higher prices. Local monopolies are also more common in areas serving the poor where only one retailer may be able to afford capital intensive goods or the market may be too small to support multiple businesses.

Further, due to limited household cash flow, poor consumers must pay more than they would like *per unit* because they cannot afford the large package sizes preferred by more affluent customers. Relatively wealthy consumers willingly "invest in inventory" by buying products that are larger than they need in the near term. While the larger purchases diminish their cash flow temporarily, the convenience of having the product in the future outweighs the temporary loss of liquidity. Poor rural consumers, perhaps struggling to meet their necessary caloric needs or pay for school uniforms, have no excess cash to invest.[10]

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[7] ibid, pg. 30-31
[8] De Soto 2000
[9] On the opposite end of the spectrum, starting a business in New Zealand requires one procedure, one day, and a cost of 0.4% of income per capita.
[10] Much of this section derives from Prahalad 2005, pg. 11-12.

In addition to price, poor consumers in developing countries are at a disadvantage on the quality side. Until recently, major brands shunned this market as too small and price conscious to meet profit goals. As a result, the poor have often had to make do with inferior, un-branded goods. Without a brand name to worry about, companies serving this market can cut costs on product safety without the risk of a backlash of negative publicity. In addition, some poor areas simply do not have goods and services deemed basic in more affluent communities, such as medicines and reading glasses.[11]

Although large corporations are sometimes disparaged, the absence of their products and services has been anything but a boon for the poor.

III. Corporations and Non-Profits: Stumbling on the Way to the "Bottom of the Pyramid"

In the past decade, a number of multi-national corporations and large domestic corporations have joined NGOs in developing strategies that cater to the poor in developing countries. Christened the "bottom of the pyramid" (BOP), this demographic segment is no longer viewed solely as the beneficiary of non-profit assistance; it is increasingly seen as a new market for corporate profit. NGOs have also recognized the benefits of approaching the BOP with a market driven operating model.[12]

Business strategist C.K. Prahalad, among others, has argued that tapping the BOP is a business imperative. The consumer segment includes, by his estimates, four billion people, a majority of the world's population. The spending power of this segment is enormous and growing. By targeting the market now, while it is young, corporations can build brand equity to be leveraged as the market matures. For their part, NGOs have come to realize that adopting a market orientation can ensure accountability. Whether intended beneficiaries will pay for an NGO's products or services is perhaps the ultimate test of the organization's value. In addition, charging for products and services can help NGOs become financially self-sustainable and enhance their ability to scale.[13]

Despite the increased focus, penetrating low-income markets in developing countries has proven difficult. Particularly in rural villages, corporations and NGOs struggle in four areas: distribution to retailers, understanding the end consumer, advertising to the end consumer, and winning the end consumer's trust.

Distribution One difficulty in building a distribution network for the BOP is that in many countries the poor are disproportionately located in remote locations. In India, where BOP efforts are perhaps strongest, 67% of the population resides in villages of less than 1,000

[11] According to LivingGoods.org, "[in Africa] it is common for rural villagers to spend a full day and up to $2 in transport to a government dispensary only to find, after waiting in a long line, that vital medications are unavailable."

[12] According to "The 21st Century NGO" report, worldwide 52% of NGO funding comes through fees for service.

[13] Examples of large international NGOs with active earned income strategies include Population Services International and International Development Enterprises. For examples of small local market-oriented NGOs, see "Social Enterprise" 2006. Fall 2006 issue of ReVista, the Harvard Review of Latin America: http://www.drclas.harvard.edu/revista/files/45743a2e80eb3/revista_fall06_print.pdf

people. As a result- and cause- of their isolation, rural villages often lack adequate transportation infrastructure. Train tracks are frequently non-existent, road access is limited, and street conditions are shoddy.[14] Sub-standard transit increases costs. As can be imagined, those transporting perishable goods are particularly disadvantaged. Inventory costs and lost sales also rise because of a long unpredictable distribution process. With less certainty as to when goods will arrive in stores, logistics planners must either tie up cash in inventory or risk stock-outs.

Understanding the End Consumer The vastly different socio-economic levels of those in the BOP and most corporate and non-profit decision-makers leads to inappropriately designed products and marketing. Corporate and non-profit executives, even within poor countries, generally have little contact with consumers in rural villages. Companies, such as Intel, Motorola and Microsoft, have hired anthropologists to live in societies and gain an understanding of their consumer needs. Nokia has a design expert engage in participatory research methods with BOP members.[15] However, their knowledge of communities of which they are only strangers can never be complete.

Advertising to the End Consumer The best market specific knowledge is worthless to a company if the resultant advertising messages cannot reach their intended recipients. While mobile phone penetration has exploded in the past decade, people in some rural areas still do not receive radio or television signals. For example, according to recent surveys, in Bangladesh there are 43 radio and six television sets per 1,000 people.[16] The limited capability to advertise hurts corporations' branding efforts and diminishes the capacity of non-profits to encourage new behaviors.[17]

Gaining the End Consumer's Trust A further challenge in some developing countries is a distrust of large corporations that may be too deeply rooted to be altered by the latest advertising message (non-profits in contrast may enjoy more sympathy). Frequently, there are legitimate historical grievances. Corporations are frequently targets of protests against environmental degradation, worker exploitation, corruption, and a host of other ills.[18]

Despite the BOP's emergence as an attractive market, the principle causes of its economic isolation continue to frustrate the efforts of corporations and NGOs.

IV. A Meeting Point: The Microfranchising Model and its Benefits

Microfranchises are small businesses operated by the poor that may be rapidly replicated in diverse contexts.[19] Franchises are ubiquitous in the developed world. They provide a rapid way for corporations to leverage their business models without investing capital beyond

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[14] Rangan and Rajan 2007, pg. 6
[15] Corbett 2008
[16] "Bangladeshi Media Statistics"
[17] Prahalad 2004, pg. 13
[18] The situation is not so clear cut, however. One reason the multi-national insurance company AIG chose to partner with the Tata Group, another multi-national conglomerate (headquartered in India), was the strong reputation the Tata brand enjoyed in the rural countryside. Roth and Athreye 2005
[19] http://marriottschool.byu.edu/selfreliance/microfranchise/about.cfm

brand equity. In the developing world, and especially rural areas, microfranchises are relatively rare, but growing.[20]

Microfranchises have developed in numerous industries with diverse business models.[21] One common feature of all the models is the simplification of entrepreneurship. Successful procedures are defined and entrepreneurs do not need to "re-invent the wheel." This feature reduces the requirements necessary to open a business and diminishes risk.

Many of the benefits of microfranchising derive from the mutual dependence between franchisor and franchisee. Franchisors want to protect their relationships with their microfranchises and the best way to do that is to see them succeed. Microfranchisees, in turn, owe their entire business to their special relationship with the franchisor. This link provides security for franchisors to invest in franchisees confident that both will reap the returns.

The relationship can provide many sources of productivity and profitability for the owner/operators of microfranchises. They often have the opportunity to receive training in service delivery, quality control, and general business skills. Franchisors may provide discounted inventory or sell inventory on consignment. A relationship with a large corporation may help improve the creditworthiness of microenterprises. It also may provide the benefits of legal formality without each individual microenterprise having to go through the aforementioned tortuous legal process. In addition, franchisors control the number of franchises in an area and can limit destructive hyper-competition. Because incentives are aligned, franchisors do not need to allocate resources to monitoring the management of franchised outlets.[22]

Further, the emergence of microfranchising can accelerate demand driven trends, benefiting all parties. Microfranchises have the potential to access a wide range of goods and services from the microfranchisor. Perhaps more importantly, they can gain knowledge of wider market trends. Compared to corporate and NGO franchisors, typical microenterprises have far fewer data points and less sophisticated systems to determine what new products and services will sell.

While corporations and NGOs have access to information on macro-level trends, they lack the microfranchisees' local knowledge and relationships. Microfranchisees are owners, not employees, and have freedom to find new means of marketing and selling based on their understanding of local conditions. At the same time, corporations and NGOs retain more control over the use of their brands than they would with unaffiliated wholesalers or retailers. The ability to enforce quality standards may be particularly important when introducing new products or services to a market or establishing a brand presence.[23]

V. Grassroots NGOs and MFIs: Leveraging Social Capital

[20] One estimate is that there are currently about 100 microfranchising networks. Burand 2009.
[21] Magley 2004 list fifteen different microfranchise models
[22] Dalberg 2009
[23] Magleby 2004 provides a comprehensive list of microfranchising benefits (pp. 23-25). Also see Hatch 2007

Microfranchise owner/operators can help corporations and NGOs reach the BOP, but first these large organizations must find a way to reach the microentrepreneurs. Typically, microfranchisors partner with a grassroots organization with local expertise to handle much of the direct interaction with potential microfranchisees. A critical advantage of partnering with an intermediary, such as an NGO or MFI is that the due diligence required to vet franchisees is outsourced. As a result, franchisors can concentrate on their core competencies. Another possible advantage is the shortening of the distribution process. Inventory is transported to the local partner, an NGO or MFI, which has a better understanding of how to transfer it to the franchisee in an efficient and cost-effective manner. However, doubt has been cast on the benefit of intermediaries assuming this role, as the capabilities required in becoming a franchising channel are generally far different from those of the NGO or MFI.[24]

Although there have been successful partnerships with NGOs, there are several reasons why MFIs may be more naturally suited to bridge the divide between the franchisors and the microfranchisees. Most obviously, MFIs can assist with the financing of microfranchises. They are well placed to determine if a franchisee can continue to borrow to finance inventory and are experienced in collecting payments from microenterpreneurs.

In addition, MFIs are well suited to choose appropriate microentrepreneurs. The survival of MFIs that offer individual loans depends on their ability to assess the trustworthiness and business acumen of their clients. MFIs are skilled in analyzing clients' cash flow history, revenue growth, leverage ratios and other financial metrics to determine whether to extend a loan. They can use these same competencies to determine which clients may succeed with a microfranchise.

Similarly, MFIs offering loans to groups, instead of individuals, can use their current operating model to find the best microfranchisees. Members of lending groups have intimate knowledge of each other's businesses. They also have an economic incentive to support only ventures with a strong chance of success. These forces lead groups to make good lending decisions and can be harnessed by MFIs to ensure good franchisee personnel decisions. MFIs can rely on members of their lending groups to select the most appropriate microentreprenuer.

Finally, culturally, MFIs are more likely to understand corporations because of their own market driven orientation. In fact, many MFIs already have partnerships with mainstream banks and insurance companies. These business relationships can be broadened to include franchising corporations and NGOs.[25]

Case Studies

While microfranchising models take various forms, all must in some way overcome the barriers of doing business with the poor. The two cases that follow illustrate models used successfully by an NGO and a multi-national corporation to scale operations rapidly in

[24] Dalberg 2009 pg. 45

[25] On the other hand, some microfranchisors, such as The HealthStore Foundation, may prefer to maintain control of all aspects of the relationship with the microfranchisor so as to assure quality. Flannery 2007.

remote locations.

1. A Non-Profit Consignment Model: VisionSpring

VisionSpring, formerly the Scojo Foundation, was formed as the non-profit arm of the commercial high-end reading glasses retailer Scojo Vision Ltd. Scojo was not the most likely entrant into rural India, Bangladesh, Mexico, Guatemala, El Salvador and Ghana. It was far smaller than other reading glasses companies and its demographic was fashion-forward, affluent Americans. Despite these obstacles, the founders of VisionSpring felt a personal commitment to bringing reading glasses to the developing world.[26]

An Unmet Demand

VisionSpring estimates there is an un-served market of 400 million people that need reading glasses in the developing world. Most people over 35 years old suffer from presbyopia, a vision problem that may be corrected with non-prescription glasses. This problem diminishes the productivity of tailors, mechanics, farmers and other laborers who must be able to see close-up. In rural villages access to reading glasses is severely limited. People sometimes have to travel days to the nearest doctor to purchase glasses designed for more affluent customers. The cost can be several days of lost work, $40-$60 for the glasses, and a doctor's fee.

Courtesy: VisionSpring.org

A Simplified Business Model for the Microentrepreneur

VisionSpring's distribution strategy is dictated by the population density and accessibility of its end markets. In urban and peri-urban areas, VisionSpring contracts with retail organizations to distribute its glasses. In rural areas, VisionSpring facilitates microfranchises, both by developing microfranchises directly and by partnering with intermediary organizations. VisionSpring's intermediary partners include NGOs, MFIs and corporations with local roots.

Either directly or through an intermediary, VisionSpring provides its microfranchisees, called Vision Entrepreneurs, a kit, known as a "Business in a Bag," with all the merchandise and marketing material needed to run the business. During an introductory training period, Vision Entrepreneurs learn marketing and sales techniques, and how to diagnose common eye problems. Then Vision Entrepreneurs are sent reading glasses on consignment. When glasses are sold, the entrepreneur pays the partner for the costs of the goods sold, and the partner passes on about half of this sum to VisionSpring. After repayment, entrepreneurs earn about $1 per pair of glasses.[27]

Local Marketing

[26] Berrie 2008
[27] Numbers are illustrative. Actual prices and costs vary by location, and are subject inflation and exchange rate fluctuations.

Vision Entrepreneurs have made wall paintings, performed skits, distributed flyers, and recorded radio spots to convey the need for reading glasses to their peers in rural villages. Another marketing technique is offering free referral services for hospitals. In so doing, entrepreneurs identify those who genuinely need to see a doctor for an eye condition and those who need reading glasses.

Expansion

Despite Scojo's small size, from its beginning in 2001 until mid-2006, VisionSpring fit almost 250,000 people for glasses. The business is able to scale by having current Vision Entrepreneurs train the next crop of Vision Entrepreneurs.

Impact on the Entrepreneur

VisionSpring has provided a source of income growth for poor entrepreneurs. For example, in Guatemala, Vision Entrepreneurs doubled their household income, even though the work is part time. In addition, given the distribution network VisionSpring has assembled, and the skills it has given its franchisees, further growth is possible. VisionSpring is considering adding additional health products to its inventory, such as nutritional supplements, sanitary napkins, and bed nets.[28]

Profits at the "Bottom of the Pyramid"?

VisionSpring comes closest to sustainability in Guatemala, covering 95% of its costs. In India, revenues cover only a quarter of costs. VisionSpring hopes to break-even by continuing to scale. Whether it reaches this target or not, the ability to reach hundreds of thousands of consumers in four different countries while dramatically lowering prices is a testament to the microfranchise model.

2. A Commercial Credit-Led Model: Hindustan Lever's Project Shakti

Hindustan Lever (HLL) initiated Project Shakti in 2000, realizing that the vast majority of the Indian population lives in rural areas. The project aims to reduce distribution costs and teach poor consumers the value of goods taken for granted in more urban areas, such as soap and iodized salt. Project Shakti is an example of both the advantages of microfranchising and the potential added value of partnering with MFIs.

Distribution

At the time HLL began Project Shakti, the multi-national consumer goods conglomerate enjoyed greater access to rural India than all of its competiters. Yet, it had only penetrated 16% of India's rural villages. A poor transportation system effectively wiped out a huge market of potential customers.

To access these markets, HLL partnered with NGOs, banks, government agencies and

[28] Kassalow, Macmillan and Blumenthal 2007, Stone 2007, "Scaling Up" 2010, "Scojo Foundation"

MFIs, to select microfranchisees. Instead of distributing goods to remote outlets, HLL sold its products to microfranchisees, who were then responsible for re-distributing them to retail outlets in the villages for which they were responsible. To earn greater profit margins, the microfranchisees also sold HLL products direct to the consumer and appropriated the retail mark up for themselves. Microfranchisees eliminated the last, most difficult, event in HLL's distribution process, reaching remote retail outlets.

Marketers from the BOP Demographic

Courtesy: hul.co.in

To gain access to reliable, business-minded community members, HLL partnered NGOs, banks, government agencies and MFIs, all of which were connected to Self Help Groups (SHGs). SHGs are groups of 10-15 women that pool their money and take turns borrowing the lump sum for individual use. SHGs may supplement their pool of capital by borrowing from MFIs and banks.

HLL hoped to project an image of "motherliness" in its microfranchisees, as reflected by the name they were given, Shakti Ammas, or "strong mothers." The members of SHGs, who must evaluate each member's business skills to make loans, were well placed to select enterprising Shakti Ammas. In this way, HLL was able to find respected and capable franchisees through a rapidly scalable process. Moreover, the image projected by the local women helped mitigate any distrust of the HLL corporation

In fact, the Shakti Ammas did display their business savvy. Some Shakti Ammas offered their regular customers purchases on credit. Others contributed a portion of their inventory to friends or relatives in neighboring villages and split the commissions.

The Shakti Ammas also helped disseminate HLL's public health campaign, which was particularly important for selling the benefits of HLL's iodized salt product. HLL's more expensive salt could gain market share only if rural Indian consumers understood that HLL's iodization process reduced the likelihood of goiters and mental disabilities. Since Shakti Ammas sold exclusively HLL branded salt, they had as much invested in improving public health through the salt as HLL. With the assurance of the Shakti Ammas' commitment, HLL invested in providing the microfranchisors training in public health and communication.

MFI Intermediaries

Shakti Ammas in SHGs connected to MFIs had a special advantage. MFIs worked out a deal with HLL that allowed the Shakti Ammas to delay their initial loan repayments for the first three months. With this extra ramp up time, Shakti Ammas could focus on ascending the learning curve of a new business without worrying about falling behind on debt payments.

Beyond the financing benefits of partnering with MFIs, the process SHGs used in selecting microfranchises could easily be replicated if a franchisor were to use stand-alone MFIs, instead of those linked to SHGs.

Economic Impact

Started in 2000, Project Shakti broke even in 2004 and the company has continued to scale up the project. According to HLL, most Shakti Ammas earn $15-$22 a month in net profit, which in some cases doubles their household income. Meanwhile, HLL has gained share in formerly inaccessible rural markets.[29]

Microfranchising: An Adapted Franchising Model

Microfranchising differs from traditional franchising in one important respect: microfranchisees are unlikely to be able to sell their ownership stakes to another operator. What microfranchisees "own" is not the right to certain assets, which are minimal, but rather a particular relationship with the microfranchisor.

Perhaps most important to the success of this relationship is the right balance between independence and control. Microfranchisors do not need to pay, manage or motivate microfranchisees, as they would employees. On the other hand, they do not cede as much control over the use of their products and services as they would through licensing or distributorship. When incentives are properly aligned, the franchisor's well developed and tested business model is paired with microfranchisees' local know-how and initiative. Mediated by NGOs and MFIs partners, this relationships can be a powerful source of wealth creation, poverty alleviation and consumer welfare.

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[29] Rangan and Rajan 2007, Roberts 2006

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