

Micro-Franchising: Application and Success Factors

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Contents

1	Introduction.....	3
2	Micro-Franchising, Micro-Credit & Micro-Consignment.....	5
3	Framework Overview.....	7
4	Business Characteristics.....	11
5	Infrastructure Requirements.....	18
6	Operational Recommendations.....	22
7	Conclusion.....	31
	References.....	32

1 Introduction

In 2005, about 1,372 million people lived on less than US \$ 1.25 a day [1]. While extreme poverty has gone down in the last decades, it is still a very serious problem in many parts of the world. Although many methods have been tried to lift people out of poverty, no one “silver bullet” has been found so far. Especially in Sub-Saharan Africa, East Asia and South Asia, where 95% of the extreme poor live, chances for the majority of the poor, most of which live in rural areas, to escape poverty are still slim. These regions are characterized by low access to most modern institutions: Bad roads and other public infrastructure, lack of human capital due to lack off access to higher education, generally low standard of living, often high level of gender inequality, to name just a few...

There is evidence that entrepreneurship is one of the key factors for economic development and, hence, for lifting people out of poverty [2]. One of the more recent tools to foster entrepreneurship is **Micro-Franchising**. The term micro-franchising refers to a business model where a micro-entrepreneur, the micro-franchisee, takes over all customer-facing activities in selling a product or service while most important non-customer-facing activities—manufacturing of a product or back-end services—are provided by a large enterprise, the franchisor¹. The idea is that the very low cost base of micro-entrepreneurs allows them to operate profitably in markets in which traditional sales channels of the franchisor cannot operate profitably due to high fixed costs. Some examples for micro-franchising businesses that we will come back in more detail later include:

- 9,000 micro-entrepreneurs in Bangladesh, El Salvador, India and South Africa diagnose minor eyesight problems and sell affordable reading glasses to rural communities that would otherwise have no access to optometrist services and eye correction devices [3]. Basic training in optometry and glasses are provided by VisionSpring, a social enterprise that acts as the franchisor [4].
- In Ghana, micro-entrepreneurs sell dairy, ice cream and milk drinks in poor areas on a bicycle. These dairy products are produced by Fan Milk Ltd., a corporation with a strong social mission. Fan Milk also provides bicycles, deep freezers, coolers, as well as credit facilities and on-the-job training to the micro-entrepreneurs that act as its sales agents [5].
- In Assam, the largest of India’s poor and predominantly rural northeastern states, micro-entrepreneurs equipped with a netbook, wireless internet access and a fingerprint scanner provide basic banking services to villagers, who would otherwise need to travel for hours to the next bank branch. Drishtee, a social enterprise, trains the entrepreneurs, provides the equipment and the processes in cooperation with a large Indian bank [6].
- More than 45,000 women throughout India sell Hindustan Lever’s soaps and shampoo in their local villages in a franchise-like model named “Project Shakti”. Hindustan Lever, Unilever’s Indian subsidiary, provides training in selling, commerce and accounting to empower these women to become micro-entrepreneurs [7].

As the name suggests, the concept of micro-franchising is very similar to traditional franchising, where a proven business model is replicated under a common brand using well-defined processes in multiple independent outlets. Although the outlets are independently owned and run, the franchisor retains control over brand, product offering, supply chain and processes of the franchising system. The advantage of traditional franchising is that, on the one hand, a company can replicate its successful business model in other locations without large capital expenditures, while, on the other hand, entrepreneurs can utilize a proven business model by licensing it. Both sides profit from the fact that a franchise system retains most ownership incentives for the franchisee, thereby reducing agency concerns for both sides.

¹ We intentionally restrict the definition of micro-franchising to customer-facing activities and to developing countries, since we think that this kind of micro-franchising generally will be most typically.

Micro-franchising generally shares all these characteristics, but also serves two additional purposes that traditional franchising concepts lack. First, it gives large enterprises access to markets that they would not be able to tap into themselves due to their cost structure. In traditional franchising, franchisors usually could in theory easily set up and operate franchises profitably on their own as well. The fact that they choose a franchising model is not necessarily driven by their inability to operate profitably in some markets, but rather a management decision about core competencies or capital expenditure requirements. Second, micro-franchising provide employment and entrepreneurship opportunities to underprivileged people, mainly in developing countries. Traditional franchising lacks this social purpose.

Success of Micro-Franchising Business Models

While micro-franchising has been around for more than a decade and despite the fact that it got some press coverage in recent years, remarkably little quantitative research on the success of micro-franchising business models has been published so far. As one of the few exceptions, L. J. CHRISTENSEN et al. did a quantitative comparison of micro-franchises of Fan Milk (mentioned above) to direct “standalone” competitors [8].

The results are encouraging. Compared to standalone dairy businesses, Fan Milk’s micro-franchisees had significantly lower start-up costs and an incredibly low start-up capital recovery time of less than seven weeks. Most importantly, micro-franchisees worked harder (more hours) and ended up with significantly higher savings and lower debt than their standalone competitors, while at the same time being younger and less educated. While this is only some first evidence, it suggests that micro-franchising can actually help people with low education get out of poverty easier than more traditional business approaches.

About this Paper

In this paper, we present a framework that organizations thinking about starting micro-franchising can use to:

- Assess micro-franchising opportunities in developing countries,
- Determine what infrastructure and services need to be provided, and
- What the key success factors in operating a micro-franchising business are.

We will start by comparing and contrasting micro-franchising to other poverty alleviation concepts like micro-credit and micro-consignment. We will then give an overview of the framework, followed by a more detailed discussion of each element of the framework.

The author of this paper worked ten weeks at Drishtee, an Indian social enterprise that specialized on micro-franchising. This paper summarizes our experiences while working for Drishtee in a consulting-like role, our learnings from interviews with Drishtee’s management, franchisees and other entrepreneurs as well as our findings from secondary research. It is in no way meant to be a complete or definitive guide to micro-franchising. For example, we will focus our discussions on micro-franchising of the customer-facing part of the value chain in rural areas. For further discussions and additional case examples, we would like to point the reader to the great publications by D. LEHR [3] and J. FAIRBOURNE [9].

2 Micro-Franchising, Micro-Credit & Micro-Consignment

In the last decade, multiple related concepts to foster entrepreneurship in rural areas have been developed. Some also received press in Western countries. At least since Muhammad Yunus and his Grameen Bank won the Nobel Peace Prize in 2006 [10], micro-credit has become well-known in the Western world. But what are the differences between the different concepts and where does micro-franchising fit in?

Let us consider four concepts for poverty alleviation: Micro-credit, micro-franchising, micro-consignment and simple donations. Micro-credit is the provision of small loans to poor individuals that want to use that capital to launch their own small enterprise. Micro-consignment is similar to micro-franchising except for one important difference: There is no requirement for upfront capital expenditures or working capital investment on the micro-entrepreneur's side. Instead, working capital in form of goods is initially provided by the franchisor, which the entrepreneur can use to generate his or her first revenue. Proceeds from the first business are then used to buy more products from the franchisor. Micro-credit, micro-franchising and micro-consignment are instruments to empower poor people to start their own business. In contrast, the purpose of donations is to ensure the survival of people, not necessarily to let them start their own business.

Those four concepts differ with respect to the risk for the entrepreneur and with respect to whether they come with a business model. Figure 1 summarizes these differences. On the high-end scale of risk for the entrepreneur lies micro-credit, where the entrepreneur is free to invest the money from the credit into whatever business he wants to pursue. The provider of micro-credit usually does not propose a business model and does not provide any infrastructure that the entrepreneur can leverage, but only capital. Therefore, the ability to repay will depend on the entrepreneurial ability of the borrower alone. In the worst case, if the enterprise fails, the entrepreneur will end up owing a considerable amount of money. Micro-franchising is a bit less risky for the entrepreneur as the micro-franchisor not only provides capital (or ways to raise capital), but also a proven business model and infrastructure for that business. The risk of failure and losing the capital is, therefore, lowered compared to micro-credit as the risk of selecting an unsustainable business model is largely mitigated through the franchising concept. Micro-consignment further decreases the risk for the entrepreneur as no or only very little initial investment and capital is required. In that concept, the franchisor bears the lion's share of the risk, as he provides working capital

	Donation	Micro-Consignment	Micro-Franchising	Micro-Credit
Risk for Entrepreneur:	None	Low	Medium	High
Delivers Proven Business Model:	X	✓	✓	X
Purpose:	Ensure survival	Creating entrepreneurial opportunity with a well-defined, proven business model		Seed capital for individual business

Figure 1: Comparison of donation, micro-consignment, micro-franchising and micro-credit models. The four models mainly differ in terms of the risk for the entrepreneur and in whether the concepts are tied to a business model. This table is adapted from [11].

to the micro-entrepreneur for free. Finally, donations are, of course, completely risk-free for the entrepreneur.

We see that micro-franchising is a concept that differs from micro-credit in that it mainly provides a proven and successful business model for replication, rather than just start-up capital. This reduces the risk for potential micro-entrepreneurs considerably, thereby also lowering the entry barriers to becoming an entrepreneur.

3 Framework Overview

Figure 2 shows the micro-franchising framework we will discuss in this paper. The three basic questions that we will deal with, and along which the framework is laid out, are:

- What are the characteristics of a business for which micro-franchising is a suitable sales channel? (→ **Business Characteristics**)
- What kind of infrastructure and what kind of services does the franchisor need to provide to franchisees? (→ **Infrastructure Requirements**)
- What are the key success factors to operating the micro-franchising business in a sustainable way for both the franchisor and the franchisee? (→ **Operational Recommendations**)

In the following, we will briefly outline these characteristics, requirements and recommendations before we discuss them in more detail along with examples in the next chapter.

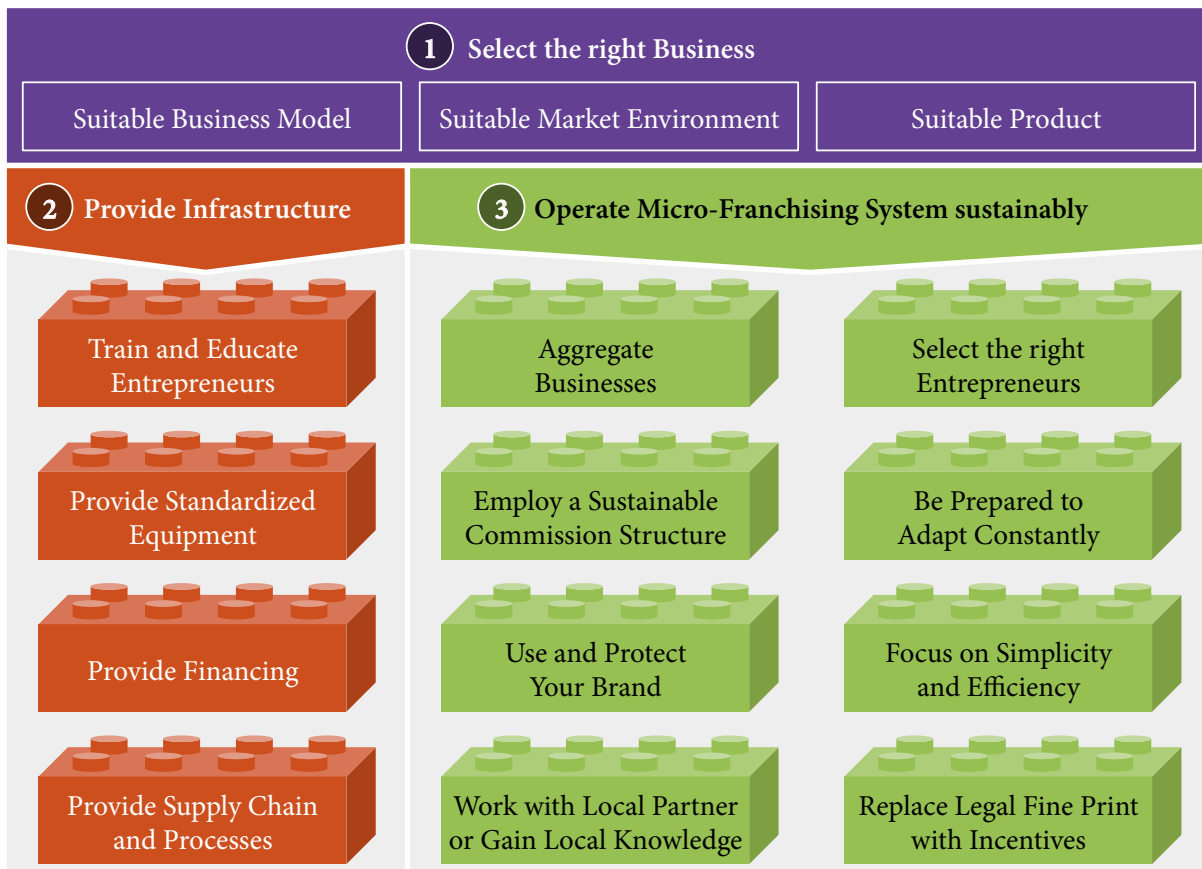


Figure 2: The Micro-Franchising Framework discussed in this paper. First, a suitable business model needs to be selected (purple). Second, the necessary infrastructure must to be provided (red). Finally, several key success factors for operating the micro-franchising system sustainably have been identified (green).

Overview of Business Characteristics

In order to determine whether a business would be suitable for micro-franchising, we have identified several criteria in three categories: business model characteristics, markets characteristics and characteristics of the products or services offered.

- **Select the right business model:** Typical candidates for micro-franchising are business models with high capital and/or operational expenditures upstream in their value chain, but low CapEx and OpEx requirements in customer-facing downstream value chain steps. Furthermore, the two value chain steps need to be separable, so that a micro-entrepreneur can take over the customer-facing activities while building upon the back-end infrastructure provided.
- **Work in the right markets:** Micro-franchising works best for markets having an access problem for the product or service in question. This means that the alternative to using the micro-franchise product or service should be sufficiently inferior or more expensive. This is usually the case only in rural areas with low population density and low income.
- **Sell suitable products/services:** Products and services that can be sold via micro-franchising must be highly standardized and as simple to explain, sell and use. Demand for the product or service must be recurring and, of course, sufficiently strong. Furthermore, the product must be priced competitively to attract customers. Finally, the achievable margin must be large enough to motivate the micro-entrepreneur.

Overview of Infrastructure Requirements

Once a suitable business for micro-franchising has been identified, a potential micro-franchisor needs to set up and provide the following infrastructure and services:

- **Train and educate entrepreneurs:** In order to allow new franchisees, many of whom have never run a business before, to manage their new business efficiently, training and education is critical. The entrepreneurs need to be educated about the products and services that they are supposed to sell, how to sell them and what commission or margin they earn on them. Furthermore, they need to be trained in how to operate their equipment, how the supply chain processes work and how to use the franchisor's process interfaces.
- **Provide standardized equipment:** As the micro-franchising can only be successful if product and processes are highly standardized, all micro-entrepreneurs should be equipped with the same standardized equipment that integrates well into the standardized processes that are provided.
- **Provide financing:** Most potential micro-franchisees do not have sufficient financial resources to afford even the small capital expenditures that a micro-franchise requires. Therefore, the franchisor must provide either micro-financing or some sort of a micro-consignment system.
- **Provide supply chain and processes:** As the capacity of the micro-entrepreneurs will be limited to running their own small shop or kiosk, all back-end activities including the supply chain must be provided by the franchisor. If physical goods are being traded, the franchisor must provide an efficient distribution network that regularly delivers directly to the entrepreneur's doorstep. If it is a services-business, the franchisor must provide a simple and efficient standardized interface that the franchisee can use for transactions/service delivery.

Overview of Operational Recommendations

Finally, there are several aspects that we have come across as typical success factors for micro-franchising enterprises. While none of these aspects is a must-have in all cases, considering these points is generally advisable.

- **Aggregate businesses:** Some of the micro-franchising businesses do not generate enough revenue to sustain the micro-entrepreneur's business and his family. As a workaround, a franchisee can run multiple micro-franchise businesses at the same time to ensure a higher total revenue stream. This can be done best by employing an intermediary (an "aggregator") between the micro-franchisor and the franchisee that aggregates the interfaces/processes of multiple micro-franchising businesses for both sides. Franchisors may increase their franchisee base by employing an intermediary who provides access to many more micro-entrepreneurs than the franchisor could attract to a micro-franchising ecosystem with only his company's offerings. And micro-entrepreneurs gain access to multiple micro-franchise business models that are provided by a single company with a common set of processes and interfaces.
- **Employ a sustainable commission structure:** The commission structure (for services) or the margin for the franchisee (for physical goods) must allow the micro-entrepreneur to cover OpEx, loan payments and sustain his or her family. Besides being high enough, earned revenue should be paid to the franchisee in a timely manner. Furthermore, the revenue stream must be quasi-continuous. It does not help if the franchisee is paid a huge lump sum one year after the business. Finally, a sustainable commission structure provides a good balance between high revenues from initial customer acquisition and recurring commissions from usage-based feed. The goal is to motivate the franchisee in the beginning, allows him or her to repay any loans and at the same time to guarantee a sustainable long-time revenue stream.
- **Use and protect your brand:** As many entrepreneurs start up with little experience, brands may help to overcome initial lack of trust in the new business. Therefore, the success of new franchisees depends partly on the franchisor's brand awareness and the credibility of the brand. This also makes the introduction of remote quality control mechanisms recommendable. Since the franchisor rarely sees the "end product" at the customer-facing side, it is difficult to recognize defects and low quality service. If quality controls are insufficient, the franchisor could permanently ruin its reputation among a group of potential future customers if it allows its franchisees to deliver low quality output for an extended time.
- **Work with a local partner or gain local knowledge:** Establishing a new micro-franchise in remote areas often requires buy-in from more stakeholders than just the entrepreneur. In many cases, stakeholders from the whole village need to be involved and convinced to make the new franchise a success. This is especially true when the micro-entrepreneur comes from a low social class or a social group that is not usually running a business (e.g. women). These cases make local presence and local knowledge a key success factor for the franchisor. Furthermore, regulation may differ significantly between countries and states, even between villages, which often prevents exact replication of business models in other regions and makes further changes necessary. Again, local knowledge is essential for understanding and mitigating these differences.
- **Select the right entrepreneurs:** Not all villagers make equally good entrepreneurs. As there does not seem to be an individual social group that consistently produces good micro-entrepreneurs, franchisors must be careful and diligent in selecting entrepreneurs. Good candidates must have passion for the business, as opposed to people who only want to become entrepreneurs to gain a higher social status. Furthermore, they must be able to create the market for their product or service. Experience has shown that people from a medium income group often fulfill these criteria best.
- **Be prepared to adapt constantly:** Few micro-franchising businesses will work perfectly from the start, even if the concept is well-developed. As the environment in developing countries is unpredictable and may change quickly, the micro-franchisor must be ready to constantly adapt the system and processes to match unforeseen conditions. A trial-and-error approach is key.

- **Focus on simplicity and efficiency:** Complex business models or processes have no chance in a micro-franchising environment. Their need for extensive training is prohibitive for a business that requires low setup costs and fast return. Therefore, any changes to the business or its operations should be evaluated in terms of how simple they are. Furthermore, franchisors sometimes deprioritize efficiency in favor of fast franchise growth. As a consequence, an explicit focus must be given to operational improvements once the micro-franchising system has grown beyond its initial stage.
- **Replace legal fine print with incentives:** Aligning the interests of business partners to elicit a certain behavior is always preferable over legally enforcing the same behavior via contracts. This general business rule is even more true for micro-franchising partnerships due to two reasons. First, contracts are often hard to enforce in remote areas of developing countries. Second, franchisees may see fine print in legal documents as a sign of mistrust and/or do not understand them. Therefore, incentivizing micro-entrepreneurs, and educating them about the incentives, is usually the best method to ensure cooperative behavior.

4 Business Characteristics

Let us now have a second, closer look at the characteristics of businesses suitable for micro-franchising. In considering which businesses might work well, we first look at the value chain to determine suitable business models and parts of the value chain. Then we discuss in which market environments the concept of micro-franchising works best. Finally, we investigate which products and services work well for micro-franchising.

It is important to note that all the characteristics listed below need to be in place to qualify a business for micro-franchising. It does not help if, for instance, the business model would in general work, but if there is no market environment that has the right characteristics.

Characteristics of Suitable Business Models

Similar to traditional franchising, micro-entrepreneurs in micro-franchising take over a part of the value chain of a larger enterprise. In general, that part can be located anywhere in the value chain. There are examples of micro-franchises where the franchisee takes over parts at the beginning of the value chain (“upstream”), in the middle, or the customer-facing parts at the end (“downstream”). J. FAIRBOURNE et al. have identified 14 different business models that can be applied for micro-franchising [9]. The box on page 12 gives an overview of these business models and their position in the value chain².

However, in this paper we will focus mostly on micro-franchises that operate the customer-facing part of the value chain. The reason for this is that we think that the advantages of micro-franchising are strongest for that kind of franchise format. First, the customer-facing part of a value chain is usually the one that the franchisor cannot serve profitably in certain regions due to its high cost structure. So by employing micro-entrepreneurs, the large enterprise is actually able to extend its market reach. This may not necessarily be the case for “franchising out” non-customer facing steps like raw material production or manufacturing. Second, running a customer-facing business generally increases the social status of the micro-entrepreneur in its community, which should be a main goal of micro-franchising. If there are no customer-facing activities, other community members may perceive the micro-entrepreneur as an employee of the franchisor rather than as an independent business man. This is the reason, why we focus our further discussion on customer-facing micro-franchise models like those of a sales agent, a local promoter, a financial inclusion franchisee or a field service technician (see box on page 12). However, many of the issues we will discuss also apply for non-customer-facing franchising systems.

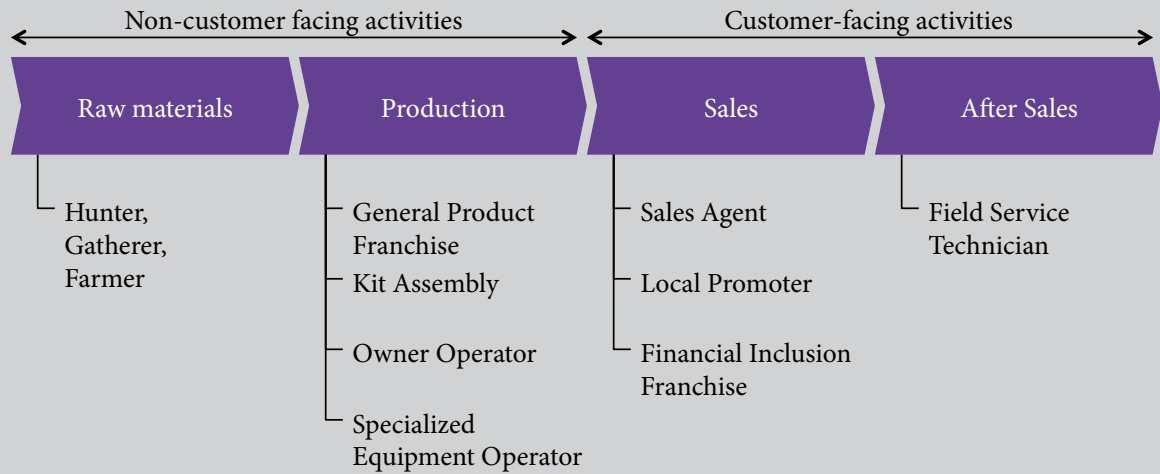
Figure 3 illustrates the generic requirements on the value chain for a customer-facing micro-franchising business model. Customer-facing franchising makes most sense when three criteria are fulfilled. First, the required capital expenditures (CapEx) to set up the non-customer-facing value chain parts, or the respective operational expenditures (OpEx) to run them, are high, such that a micro-entrepreneur (or any of his potential competitors in his market) could never afford them. Second, the customer-facing part must be separable from the non-customer-facing part in the sense that it is actually possible to have the customer-facing activities done by someone else than the producer. Third, CapEx and OpEx for the customer-facing activities in the considered market environment must be considerably lower for a micro-entrepreneur compared to the costs for the franchisor to enter that market with a traditional approach.

Let us illustrate these three rather generic principles by looking at an example. The State Bank of India (SBI), one of India’s largest banks, operates a financial inclusion micro-franchising system, in which micro-entrepreneurs provide basic banking services to poor people in rural areas³. Micro-entrepreneurs

2 In fact, we think that five of the 14 business models are only minor variants of other business models, so we only present nine models that we think are actually distinct.

3 SBI’s micro-franchising ecosystem is actually run by independent social enterprises like Drishtee, which act as intermediaries and connect micro-entrepreneurs to SBI’s interface. However, for this consideration that fact is not important. We will come back to the role of intermediary companies like Drishtee later when we talk about business aggregation as an operational recommendation.

Micro-Franchising Business Model Samples along the Value Chain



Franchise Format	Description	Examples
<ul style="list-style-type: none"> Hunter, Gatherer, Farmer 	<ul style="list-style-type: none"> Franchisor guarantees purchase and price for products that micro-entrepreneurs hunt, gather or farm Franchisor also facilitates best-practice sharing among the franchisees 	<ul style="list-style-type: none"> Unilever locally sources soy beans in Indonesia from farmers for a guaranteed price Fair trade networks for coffee and other products
<ul style="list-style-type: none"> General Product Franchise 	<ul style="list-style-type: none"> Franchisee licenses franchisor's products or technology to local entrepreneurs 	<ul style="list-style-type: none"> Unilever's Annapurna Salt in Ghana: Production process for micro-encapsulation of iodine in ordinary salt licensed to local salt producers Paper-to-Pearls lets women in Uganda manufacture necklaces from paper and sells them in Western countries
<ul style="list-style-type: none"> Kit Assembly 	<ul style="list-style-type: none"> Franchisor provides micro-entrepreneurs with product kits that still need to be assembled or finished 	<ul style="list-style-type: none"> Arvind Mills Jeans in India: Local tailors stitch custom-made jeans for \$6 a piece from an assembly kit
<ul style="list-style-type: none"> Owner Operator 	<ul style="list-style-type: none"> Owners of machinery, cars, trucks or other equipment work as franchisees under the franchisor's brand Ownership of the equipment usually leads to improved performance and better treatment by the operator 	<ul style="list-style-type: none"> Some taxis or auto-rikshas in the developing world are owned by the driver but operate under a franchisor's brand

Franchise Format	Description	Examples
<ul style="list-style-type: none"> Specialized Equipment Operator 	<ul style="list-style-type: none"> Franchise sells franchisees a special purpose equipment/tools that allows them to start their enterprise Franchise runs supply chains for the equipment or tools they are selling 	<ul style="list-style-type: none"> Kick Start in Kenya sells simple, inexpensive, but versatile irrigation pumps to farmers that they can not only use to irrigate their own land, but also to provide the same service to other farmers
<ul style="list-style-type: none"> Sales Agent 	<ul style="list-style-type: none"> Franchisee sells franchisor's products in their own premise 	<ul style="list-style-type: none"> Hindustan Lever/Unilever Project Shakti in India: Women sell hygiene products in their own small kiosks Fan Milk in Ghana: Entrepreneurs equipped with a bike and a cooler sell dairy products in areas without access to regular supermarkets
<ul style="list-style-type: none"> Local Promoter 	<ul style="list-style-type: none"> Micro-entrepreneurs organize and advice neighborhood self-help groups with a purpose (e.g. to build family homes), for which products of the franchisor are required The promoters serve as trusted administrators of funds used to buy the franchisor's products or services This way, the self-help group can profit from expert knowledge as well as improved purchasing conditions for their project 	<ul style="list-style-type: none"> Cemex "Patrimonio Hoy" system in Latin America: Poor construction standards and leakage of material like bricks or cement are a problem for families slowly building their homes. Local promoters organize self-help groups, connect them to local architects and help source cement just-in-time for their construction. Money is collected from group members into a fund, out of which just-in-time cement deliveries are paid.
<ul style="list-style-type: none"> Financial Inclusion Franchise 	<ul style="list-style-type: none"> Micro-entrepreneurs run a one-man bank branch to provide access to basic banking services (checking account and other simple products) to underserved people Technological advances like inexpensive netbooks, wireless internet and the widespread availability of cell-phones enable access to the franchisor's banking interfaces 	<ul style="list-style-type: none"> Eko-Mobile in India: Entrepreneurs provide banking services via cell-phones at their kiosks Drishtee kiosk banking in India: Entrepreneurs with a netbook, biometric scanner and internet connection provide a no-frills checking account in remote rural areas Western Union branches throughout the world
<ul style="list-style-type: none"> Field Service Technician 	<ul style="list-style-type: none"> Franchisor trains entrepreneurs in performing minor repairs and maintenance for the franchisor's products Entrepreneurs then service a specific territory using their own tools 	<ul style="list-style-type: none"> Temasol photovoltaic installations in Morocco: Trained micro-entrepreneurs (former electricians) provide service and maintenance for roof-top photovoltaic installations

Source: Business model samples adapted from FAIRBOURNE, GIBSON, DYER [9]; Project websites

are equipped with a netbook, a biometric scanner (fingerprint scanner) and a wireless internet connection and use this technology to access a simple web-based banking interface provided by SBI.

What do the three generic value chain criteria mean in this case? First, the investment to set up and run a bank infrastructure are considerable. Initial equity must be high enough to create the bank's back-end (IT systems, risk management, ...) and secure customer deposits. No rural micro-entrepreneur could ever come up with enough equity to do these investments himself. Note that we only refer to the CapEx required to get the back-end of a bank going, not the costs to set up a bank branch network. Second, the front-end (customer-facing) and back-end (non-customer-facing) activities can be separated due to the advent of technology that made a web-based interface to SBI's banking services possible. Of course, the complexity of products that can be served via a simple, standardized and automated web-interface is limited. For instance, that kind of system would not be suited to assess credit risks for villagers, as there is definitely no credit score available. Hence, provision of credit using that interface is not possible. Third, setting up a network of bank branches that completely covers all rural areas would not make economic sense for any bank. Demand for margin-generating products is low in most poor areas and, hence, no traditional bank branch could operate profitably there. However, this is different for the one-man-bank-branch approach using the web-based interface. Since the required investments—for a netbook, a fingerprint scanner and wireless internet access—are low, the CapEx/OpEx requirements for micro-entrepreneurs are substantially lower than for SBI's traditional branch network approach. In summary, this situation is ideally suited to host a micro-franchising system: Micro-franchising give micro-entrepreneurs the opportunity to provide a product/service that they could not provide if they had started an independent business. Modern technology makes it possible to separate the front-end from the back-end infrastructure and let a micro-entrepreneur take over all customer-facing activities.

Characteristics of Suitable Market Environments

Besides considering the business in general, micro-franchising also needs a certain kind of market to work well. As we have mentioned above, the customer-facing micro-franchising model works best in areas where the traditional branch- or store-based approach of larger enterprises would not be profitable. This is typically the case in areas that have either a low population density, low average income or both. A similar situation can also exist for special-purpose products or services if there is simply low demand for that product or service, despite a certain population density and despite non-marginal average income.

Of course, the demand should not be too low. It must be high enough to be able to support a micro-entrepreneur. Furthermore, demand for the product or service should be periodic and the typical period between two purchases should not be too long. Otherwise, an initially very successful business idea may stall after some time if the demand is not periodic. Or the working capital requirements may become unsustainable if the periods between purchases are too long.

For example, Drishtee, an Indian social enterprise that today specializes on micro-franchising, started out in 2000 by providing e-government services in rural areas [14]. Using a web-interface, micro-franchisees provided certain civil administration services, such as the application for licenses or certificates⁴. Villagers were very fond of using Drishtee's services, as they spared them the trip to the nearest civic center—a trip that could potentially take all day, not including the long waiting times at the office. However, after initial success, demand decreased considerably and made e-government services as a standalone micro-franchising business model unsustainable. The reason was that demand for licenses and certificates is not periodic, or that the periods are too long. People do not require a new license or certificate every couple of months, but probably only every couple of years. So, after initial high demand

4 Many government or social services in India require the applicant to present a certificate that he or she is eligible for the service. For example, there are often lower caste reservations in government or education jobs. In order to prove eligibility to apply for a reserved spot, applicants need to present a caste certificate. Similarly, access to various social benefits also requires birth certificates, income certificates or marriage certificates.

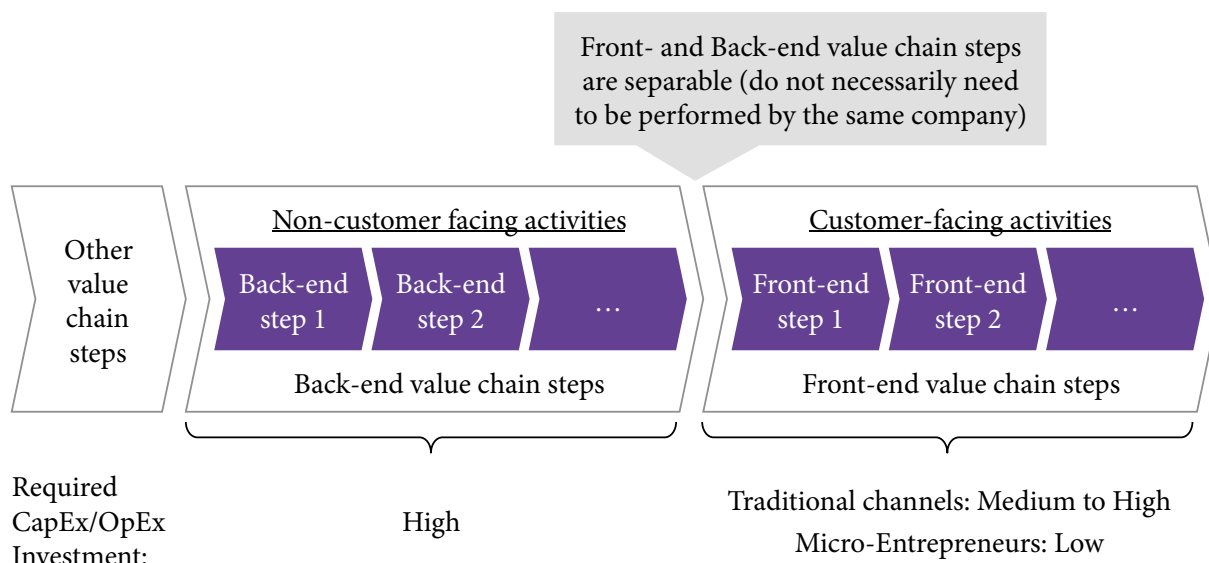


Figure 3: Value chain position of micro-franchises considered in this paper and typical generic requirements for a customer-facing micro-franchising system.

had been fulfilled, revenues came down. Drishtee had to react by changing its business model towards offering a more diverse set of services for micro-franchising, which have more periodic demand patterns.

Besides the generic demand and purchasing power requirements on the market, it is very important that there is a significant **access problem** for the product or service under consideration, i.e. the next best alternative to that product or service is either much inferior, much more expensive or both. The lack of an access problem usually greatly diminishes the chances that a micro-franchise would succeed.

Coming back to the example of Drishtee: After moving away from an e-government services-only business model, Drishtee also added computer training services to its portfolio of micro-franchising businesses. Drishtee provides capital to the franchisees to buy computers and trains them in running the Drishtee Computer Center. The franchisees then offer affordable computer training services to people in their village to prepare them for basic work on a computer, e.g. in a rural BPO center. A few years ago, Drishtee decided to enter the market in the northwestern Indian state of Punjab and recruiting several initial micro-entrepreneurs to try the concept in this new environment. However, after a while it became clear that this micro-franchising business was not sustainable in this state. As it turned out, the access problem was not high enough. Punjab is one of India's richer states and has a relatively high average income, is densely populated and has relatively good public infrastructure. As a consequence, the access problem for computer training services was not sufficient. Many people could afford training in the city and decent infrastructure provided them with a fast way to get to the city. There they could get better training than in Drishtee's Computer Centers, for a premium that they could afford. Drishtee had overestimated the magnitude of the access problem.

Characteristics of Suitable Products and Services

Not all products or services are equally well suited for micro-franchising. The environment that most micro-entrepreneurs work in mandates some obvious requirements for products and services. They must be extremely easy to understand. If they are not, even if the micro-entrepreneur understands them, chances are that his customers will not, in which case they will also not buy them. The fact that most people have little or no education in the areas that micro-franchises usually work in, restricts the complexity of the products considerably. In general, no higher education should be required to explain and sell the prod-

ucts or services. Likewise, products and services must be understandable and usable for customers with little or no education as well.

“If it takes more than two weeks to teach the workings of a model, then the franchising model is too complex!” [3]. This quote from a workshop on franchising in India in 2007 nicely summarizes the need for simplicity in the business model and in the product. As a consequence of that need, products and services must be highly standardized, both in terms of features and price. On the one hand, features need to be standardized and there should not be much choice between different variants or options. This is required not only due to the fact that fewer choices make it easier for the entrepreneur to explain and sell the products. It also limits variability and complexity in the supply chain, which is one of the major pain points for many micro-franchising systems. As micro-franchises are often located in remote areas that are hard to reach since roads are bad or non-existent, ensuring a steady supply of one product is already difficult. If multiple products need to be delivered or kept in stock, the increased complexity would further strain the weak supply chain. In the very best case, they would only drive up working capital.

Similarly, customized products or services are very hard to implement unless the micro-entrepreneur can do the customization on the spot. For example, VisionSpring, a social enterprise whose franchisees diagnose minor eyesight problems and sell affordable reading glasses to rural communities, sells only standardized single-focus or bifocal eyeglasses with standardized optical powers. If the customer’s eyesight problems are more complex (e.g. astigmatism or myopia) and cannot be treated with the standardized glasses that VisionSpring micro-entrepreneur carry, the entrepreneur will refer them to a partner shop or partner eye hospital [13].

On the other hand, pricing must be relatively standardized as well, as more complicated pricing schemes would be hard to communicate to villagers. The loss in transparency for customers that comes individual pricing would not only undermine their trust, but the added complexity can potentially also create problems in the figuring out the commission for the micro-entrepreneur.

If micro-enterprises are located in rural areas, products and services should be adapted to the needs of rural markets. For example, for fast-moving consumer goods (FMCG), packaging sizes should be adapted. While urban households tend to buy in bulk—even in developing countries—rural and poor households do not want to spend that much money on stocking up on hygiene products or soups, even if that would give them a better per unit or per volume price. Instead, they prefer to buy very small quantities on demand, sometimes “single use packages” that barely contain enough quantity for one application.

Besides these characteristics of products that have a chance of being successful as part of a micro-franchising system, price-point and margin for the franchisee are, of course, two important factors as well. It is no surprise that customers of micro-franchisees, especially in rural and poor areas, tend to be extremely price-sensitive. If the price is too high, these customers will often aggregate demand in self-help groups, send someone to make the trip to the nearest city to buy in bulk there. To assess what price will be considered competitive, one has to put a price tag on the access problem mentioned above. This estimate of what it would cost customers to buy from the next best location defines the maximum premium that customers of micro-franchises may be willing to pay over the retail price or fee for the same product or service in towns.

Finally, the margin for the micro-franchisee must be high enough to keep the micro-entrepreneur motivated. At the very least, income from this business must cover any OpEx plus interest for any loans. We will discuss the characteristics of a sustainable commission structure below. However, for potential micro-franchisors it is important to note that it is not easily possible to artificially increase the margin for micro-franchisees versus other sales channels by just lowering their wholesale prices for micro-franchisees.

Unilever/Hindustan Lever experienced that in their micro-franchising Project Shakti, in which women become micro-entrepreneurs by selling Unilever’s soaps and shampoos. With best intentions Unilever tried to give the Shakti women 2% additional margin by reducing their wholesale price. However, this margin scheme was quickly stopped when Unilever found out that many of the women misused their privilege to buy at 2% lower wholesale prices. Instead of serving their own business in their rural

home cities, some women started selling large quantities to regular wholesalers and supermarkets, passing on 1% from margin advantage to the wholesalers and pocketing the remaining 1% for themselves.

This illustrates why margin differentiation is hard to implement. As a consequence, franchisors will basically have to sell to micro-entrepreneurs under the same conditions as to every regular wholesaler or store. Hence, a micro-franchising system that needs the company to lower margins micro-entrepreneurs in order to be operate profitably, should think again.

5 Infrastructure Requirements

Once a suitable business model for micro-franchising has been determined based on the characteristics discussed above, a future micro-franchisor should put the necessary infrastructure in place.

Train and Educate Entrepreneurs

For many micro-franchisees, this is the first time in their lives they run a business. Few have any training in managing a business, so instructing new micro-entrepreneurs is one of the key services that a micro-franchisor should provide. After all, one of the main value propositions of micro-franchising versus micro-credit is the provision of a proven business model, which also means that the model must be explained in detail to all micro-franchisees.

Conducting the training early on is critical. Micro-entrepreneurs should not start their business without having completed the training first. If they do not, they risk losing trust in their community early on if they mishandle business situations due to their lack of knowledge. Ideally, all required trainings should be completed in one (multi-day) session before the new franchisee receives his equipment. As business models should be simple anyway, it should be possible to teach all essential business operations within days. Phased trainings, i.e. additional training sessions for the micro-entrepreneur after the franchise has been in operation for a while, are also a possibility. However, the difficulty of traveling to or from remote areas is the main obstacle when doing phased trainings.

Another problem is finding the right level of training. On the one hand, micro-entrepreneurs often lack basic managerial training and profit immensely from any kind of business education. On the hand, training for a micro-franchise cannot and should not replace a college degree in business administration, as the business models at hand should be simple enough to operate without a degree anyway. Also, the costs for elaborate trainings are simply too high for both franchisors and franchisees. For example, in 2006 the Government of India approved the creation of a state-run micro-franchising system to set up 100,000 “Common Service Centers” (CSCs) as part of a national e-governance initiative. These CSCs were supposed to provide e-government services in remote areas via kiosks run by micro-entrepreneurs. Besides e-government services, these centers could also engage in other businesses, as the creators of the CSC scheme foresaw that commissions from e-government services alone would not be sufficient to make this a sustainable business for most micro-entrepreneurs. To train micro-franchisees, an elaborate training program was made part of the program [15]. Professors from well-respected IIM business schools devised a training program by stripping down their two-year MBA curriculum to a few weeks. However, that proved to be an overload for most of the entrepreneurs and the program apparently continues to struggle with the lack of business skills in many of its micro-franchisees.

Besides the initial training on business basics and how to operate the micro-franchise, on-going education of entrepreneurs is essential as well. As micro-franchising business models evolve over time, processes and commission structures change, and micro-entrepreneurs need to be educated about those changes. Furthermore, in our interviews with micro-franchisees we often got the impression that they did not fully understand what products and services would give them the maximum revenue or commission. Finally, best-practice sharing among the franchisees can be a source of significant value for the micro-franchising system. Therefore, micro-franchisors should think about how they can set up a system for continuous education of their micro-franchisees. As an added benefit, staying in touch with them also enables the franchisor to better understand what is going on in field and what concerns are troubling the franchisees. At Drishtee, regional managers often travel to remote areas for education sessions with a large number of franchisees. In these sessions, the managers not only inform the franchisees about changes in their businesses and processes, but they also serve as forums for the franchisees to articulate concerns and let the franchisor know about their problems. Finally, these conventions are also an information session for potential future franchisees.

Provide Standardized Equipment

In traditional franchising, a common customer experience and process efficiency can be fostered by harmonizing equipment and machinery across all franchises. This is even more true for micro-franchising systems. New rural entrepreneurs usually do not have a good understanding about what kind of equipment is suited best for the business they are starting, so providing them with the right equipment is essential for their success. Furthermore, if franchisees had different equipment, coordination, support and, depending on the type of business, a common supply chain would be harder to provide. Therefore, the franchisor should determine what the best equipment is and provide that to the franchisee. This does not mean that the franchisor should necessarily give it to the franchisee for free, but it should also provide financing for the many cases where new micro-entrepreneurs do not have sufficient funds to afford the investment right away (see next section). For example, to provide their kiosk banking micro-franchisees with the necessary equipment, Drishtee has developed a system consisting of a netbook, a biometric (fingerprint) scanner, a USB wireless internet device. For entrepreneurs, the netbook comes pre-installed with all necessary software to access the State Bank of India's web-based kiosk banking interface. Drishtee mandates that only this hardware is used for their kiosk banking and new franchisees have to buy the system when opening a new kiosk. Financing options are provided by Drishtee, too.

Ideally, equipment can be bundled with other tools into a backpack as a “**business in a bag**”. This bag should include all necessary equipment like tools or machinery, an initial set of products to sell (if the purpose is to sell products), easy-to-understand manuals as well as some marketing material. For example, VisionSpring gets their micro-entrepreneurs started by selling them a business in a bag that contains [3]:

- Screening equipment with eye-charts to test near- and long-distance vision
- An initial set of reading glasses in various styles, colors and powers in a VisionSpring box
- Cases, cleaning cloths and eye drops
- Brochures, display boxes, posters and flyers that can be used for marketing purposes
- Copies of magazine articles about VisionSpring to increase credibility and trust among potential customers

New VisionSpring micro-franchisees are required to buy this kit for about US \$12. This price does not include the initial set of reading glasses, which is delivered on consignment.

Provide Financing

Most micro-entrepreneurs will initially not be able to finance the start-up costs of their micro-enterprises out of their own pockets. Micro-franchisors must, therefore, provide financing options to their franchisees. The most obvious option is to partner up with a micro-credit company to give franchisees access to micro-credits with a fixed amount on predefined terms for starting the new franchise. When assessing an appropriate amount for the loan, the following costs should be considered:

- Capital expenditures for all necessary equipment (the “business in a bag”)
- Any one-time or recurring registration/licensing fees (for the franchisor or the government)⁵
- Working capital for the business

Depending on the business, start-up costs for micro-franchises range between few US \$ to several thousands of US \$ [16], with start-up costs for developing countries typically only going up to some hundreds US \$ (for business models involving computer hardware, for instance). Repayment times for micro-franchising loans are typically in the range of a few months to 2-3 years. In some cases profits from micro-

5 Recurring fees should only be considered up to a certain time. That certain time is determined by how fast the business is expected to grow and by when it is expected to become profitable for the first time.

franchising are high enough to allow repayment of the loan within weeks. For example, the dairy salesmen of Fan Milk in Ghana can typically pay back their initial loan within seven weeks after starting-up [8].

The problem of financing is not only limited to the immediate start-up phase of a new franchise, but will likely also exist during the first months of a new franchise's operation. Initially, micro-franchisees may not have enough liquidity to pay the franchisor as a supplier of goods or services. There are three options for the franchisor to mitigate this problem:

1. Include working capital for the purchasing of goods or services in the initial loan
2. Provide other forms of financing, e.g. weekly or monthly installments
3. Provide goods or services on consignment

The third option actually moves the micro-franchising model a bit into the direction of the micro-consignment model (see chapter on micro-franchising versus other models above). In that case, the micro-franchisor assumes the risk for the goods or services delivered.

The Indian social enterprise Drishtee also operates an FMCG supply chain for small shops in remote rural areas in India. A small auto-riksha truck is loaded with FMCG products like hygiene products, laundry detergents, instant noodles, biscuits and chocolate. It then drives a route spanning 40 villages a day to offer the products to registered small shops/kiosks along the route. When buying products from Drishtee, shopkeepers have the options to either pay in full, or to pay a week later when the truck stops by the next time. This latter option is quite popular among shopkeepers, as they often do not have sufficient cash to pay for the goods. Drishtee assumes the credit risk for that week, but will not sell any further goods before last week's credit has been paid back in full.

Provide Supply Chain and Processes

One of the main advantages of the micro-franchising model is that it provides micro-entrepreneurs with a proven business model and the required infrastructure, which they could never afford to set up on their own (due to high capital or operational expenditures). So the final components needed for a micro-franchising system are the processes that allow the micro-franchisees to access the infrastructure of the franchisor and, in case physical products are traded, an efficient supply chain.

Setting up a supply chain in rural areas in developing countries is a very difficult challenge. All concepts, requirements and limitations that are in effect for efficient supply chain management in developed countries also apply for developing countries. However, there are some factors that make the situation for micro-franchising in developing countries even more difficult:

- **Extremely low order volumes:** Compared to developed countries, volumes can be tiny. Small shops or stores usually do purchase a whole pallet of goods, often not even a box, but only a couple of single units. Therefore, delivery vehicles usually need to carry a lot of SKUs in small quantities in order to operate profitably. It makes sense only for very few high volume FMCG products to run dedicated truck routes.
- **Variability and unpredictability of demand:** There are often no standing order volumes, but franchisees choose products and quantity they want to purchase from the franchisor on the spot in a more or less random fashion. Pre-ordering systems, where the franchisee lets the franchisor know some time in advance what goods he or she needs, are hard to establish. When trying to optimize their FMCG supply chain, Drishtee introduced a pre-ordering system where shopkeepers had to call in to place orders a day in advance before a scheduled route to their shop departed. However, after some months Drishtee abandoned the system and returned to the previous practice of just trying to guess what shops on the route were likely to buy that day. The reason was that, despite the fact that most shopkeepers had cell phones, they did not call in to place orders. Or, if they did, they ended up not buying what they ordered but choosing something else that they had not ordered. As the fulfillment of orders placed on a phone is virtually impossible to enforce, not to mention to

immediate loss of trust of shopkeepers in Drishtee, they decided that the additional overhead for phone orders was not worth the effort and switched back to the old system.

- **Bad roads and transportation infrastructure:** In developed countries, the availability of GPS systems, highly accurate electronic maps that list each and every street, real-time traffic information and generally good road quality have made the accurate estimation of travel times for car or truck routes possible. In developing countries, usually none of the above factors is present, at least not in rural areas. This makes planning of routes without local knowledge very difficult and requires the build-in of relatively large time buffers to plan for unforeseen events like flooded roads or other delays.

In their FMCG supply chain for rural shops, Drishtee therefore relies on a dense network of regional distribution centers/warehouses. Auto-riksha trucks operate within a radius of about 20-30 km (12-18 miles) from these warehouses. As there are no reliable maps of the area that includes all the villages and small roads, route planning is done manually by local managers, who know the roads by heart. Delivery vehicles usually take a different route every day to make sure that each registered shop is covered at least once a week. The purchasing of goods from suppliers as well as the decision what gets loaded onto the trucks is done locally by the centers, although there may be optimization potential for a more coordinated purchasing effort.

If the micro-franchising business is a service business, no physical supply chain may be needed. In this case, focus needs to be put on the ease-of-use and efficiency of the interface between franchisee and franchisor. That interface can be implemented via internet, cell phones (calls or SMS), via postal services (rare) or in person (if there is regular personal contact between franchisor and franchisee). With the advent of wireless data coverage and affordable fees even in remote areas, a web-based interface is becoming option of choice in many cases. In general, the interface between franchisor and franchisee needs to provide the following functionality:

- **Provision of the service (if the product is a service):** Ideally, the whole service delivery of the franchisor towards the franchisee can be done via one single interface. For example, Drishtee's kiosk banking uses a web-based interface that micro-franchisees access via a netbook with a wireless internet connection. After logging in, the interface allows the micro-franchisee to provide basic banking service to his customers. In conjunction with the biometric scanner, customers can open accounts, deposit & withdraw money and do remittance.
- **Reordering of goods or raw material (if the product is a physical good):** Franchisees should be able to request replenishments of goods or raw materials.
- **Usage Statistics & Commission Invoicing:** Franchisees want to know what they are earning in commissions or how much business they have been making. As book-keeping and accounting may be difficult for the micro-entrepreneurs, being able to track their sales, their volume or their success using the interface is helpful for them. Also, if the micro-franchising is based on a commission or revenue-sharing model, being able to get information about how much money they are making is important for franchisees, too.
- **User detail changes:** Franchisors have an interest in being up-to-date about addresses and contact details of their franchisees, especially their cell phone numbers. Therefore, the interface should allow to change these details.
- **Support and communication:** Finally, the interface should provide two-way communication between franchisee and franchisor to enable the franchisor to communicate news or changes in the business model and to enable the franchisee to ask for support.

Each of the above items corresponds to a process that the franchisor needs to provide to the franchisee. Needless to say that each of the processes should be as simple as possible and easy to use for franchisees.

6 Operational Recommendations

We conclude the discussion of our framework with eight recommendations on how to operate a micro-franchising system after the proper business model has been chosen and the necessary infrastructure has been put in place.

Aggregate Businesses

We have argued that one of the reasons why micro-franchising might make sense for large enterprises is that their cost structure is too high to operate profitably in areas where micro-entrepreneurs with a much lower cost base might be able to operate profitably. However, in many cases the underlying market is really too small or demand not regular enough to sustain an individual micro-entrepreneur.

One option to nevertheless allow micro-franchising in these areas is to aggregate multiple micro-franchise businesses and enable entrepreneurs to run multiple micro-franchising businesses at the same time. Aggregating multiple franchises that require similar infrastructure (e.g. computer plus internet access) and, ideally, a similar skill set can provide a sustainable revenue stream to micro-entrepreneurs even in regions where demand for one product or service alone is too low.

The best way to realize this model is by employing an intermediary between micro-franchisors and micro-franchisees. Let us call that intermediary a micro-franchising “aggregator”. On the one side, the aggregator company aggregates the offerings of multiple large enterprises that are willing to franchise and sets up interfaces to them. On the other side, it provides micro-entrepreneurs access to the various micro-franchising models it aggregates. In this system, the role of the micro-franchisor is split up between the actual franchisors and the aggregator company. The franchisors continue to provide the actual physical goods or the back-end services that are traded, while the aggregator takes over the set up and the operation of the micro-franchising network. To do that, it must provide the required infrastructure—training, equipment, financing and the supply chains and processes—that we discussed in the previous chapter. This is illustrated in Figure 4.

We have already mentioned the Indian social enterprise Drishtee in multiple examples. What we did not mention, yet, is that Drishtee is in fact a micro-franchising aggregator. Drishtee’s mission is enable access, empower women, develop enterprises and revive rural economies by the means of micro-fran-



Figure 4: Illustration of the role of a micro-franchising “aggregator” business as an intermediary between franchisors and franchisees. While multiple franchisors provide the physical goods or the services that form the base of a micro-franchising system, the aggregator provides the required micro-franchising infrastructure and coordinates the micro-entrepreneurs.

chising. It focuses on the Indian states of Assam, Bihar and Uttar Pradesh. Drishtee sees itself as “network orchestrator” for the multitude of franchising opportunities that it offers to micro-entrepreneurs. Specifically, the micro-franchising areas are:

- e-government: Drishtee originally started as an e-government franchising system. In this case, the franchisor is the Government of India and micro-franchises provide administrative services like applications for licenses and certificates.
- Healthcare: Drishtee trains women entrepreneurs to provide basic healthcare services for a cluster of villages. Besides learning about business operations, these women also receive training in first aid, noninvasive diagnostics and pathological tests.
- Education: Drishtee’s micro-entrepreneurs run small education centers. Most of them teach basic computer skills and/or English. The purpose of these courses is to educate villagers to the extent that they are skilled enough to work in the rural BPO industry. Vocational courses (e.g. on farming issues) are also offered by some centers.
- Financial inclusion: Drishtee operates several micro-franchising models to provide basic financial services to poor rural people. Besides the web-based kiosk banking approach, which we already mentioned a couple of times above, Drishtee’s micro-franchisees are also active in the areas of micro-credit, insurance and as “business facilitators”⁶.
- FMCG distribution: Drishtee also runs an FMCG supply chain for small shops/kiosks in remote rural areas. Products distributed include biscuits, instant noodles, detergents and other products.

To provide these micro-franchising opportunities, Drishtee collaborates with different large enterprises. For example, the financial inclusion franchising is provided in collaboration with the State Bank of India.

Micro-entrepreneurs can choose to participate in multiple micro-franchising systems. Most financial inclusion micro-entrepreneurs that work with Drishtee do not only run a web-based kiosk banking business, but also act as “business facilitators” for financial products. Furthermore, during our field visit we noticed that many of these entrepreneurs also run Drishtee Computer Centers to offer computer education services. This makes sense because the commissions from each of these micro-franchise businesses alone are often not sustainable and because the skills needed to run a computer education center (good computer skills) are somewhat similar to the skills required for operating the netbook-based kiosk banking.

Employ a Sustainable Commission Structure

A common problem in micro-franchising is that there is demand for the product or service, but the commission or revenue structure is designed in a way that makes the business unsustainable for the micro-franchisee. This is a problem especially for service-based franchising models. In general, the commission or revenue structure must lead to a revenue stream to the micro-franchisee that fulfills the following criteria:

- On average, revenue must be high enough to cover operational expenses of the entrepreneur, franchising fees, his or her interest cost and principal repayment and, on top of that, contribute to the income of the family.
- Revenues must not only be sufficiently high, but they must be quasi-continuous, as it does not help if a large lump sum is paid out at the end of each year. For revenue to come in continuously, revenue from sales to customers must be periodic and commission payouts by the franchisor must be periodic as well.

6 “Business facilitators” are persons whose business it is to assist people with low or no experience in financial products in filling out application forms for financial products like savings accounts or insurances for a commission. Their activities are similar to insurance agents in developed countries.

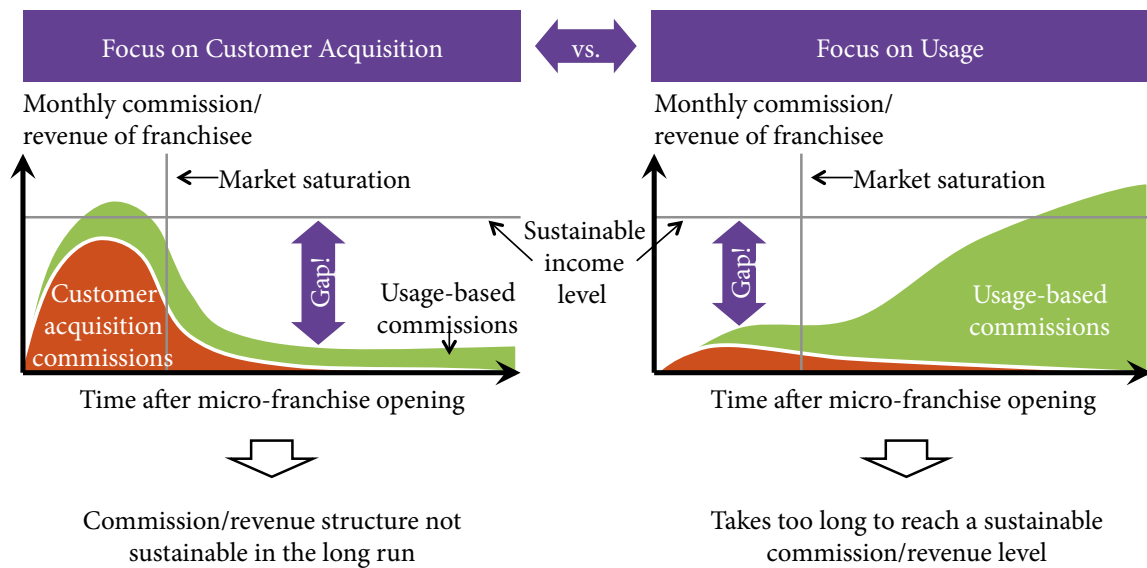


Figure 5: Illustration of two typical design flaws in commission structures: Too much focus on commissions for customer acquisition (left) and too much focus on usage-based commissions (right).

- Revenue or commissions must ramp up quickly enough to minimize the time it takes for the business to become profitable. If it takes a year to break-even, most franchisees will quit before that time as they cannot afford to live without income for that long.

While not all of these factors can be ensured by designing a good commission structure, some can. Of course, a business that is unprofitable because it operates in an area without sufficient demand for its products or services cannot be turned profitable by just changing the commission structure. However, the success of a micro-franchising business that is generally viable can be endangered by not carefully thinking about the consequences of how a commission structure is designed. Especially for service-based businesses, there is usually some room for decisions on which activities franchisees are rewarded for by a commissions and for which they are not.

Two common design problems in commission structures are illustrated in Figure 5. Typically, commissions in service-based franchising systems can be separated into commissions paid on the acquisition or retention of customers and in commissions paid for the use of services by customers. These two commission types need to be carefully balanced to avoid one type dominating the other. This not only may have negative effects on what franchises spend their time on (generating new customers versus increasing service usage), but also on whether a commission structure is sustainable for the franchise. The left hand side of Figure 5 shows the effect of a commission structure that pays well for the acquisition of customers, but disproportionally less for the usage of the service by customers. While this allows franchisees to quickly reach a sustainable commission level by making more and more customers sign up, usage-based commissions are too low to sustain the high commission level once saturation effects in the local market lead to a strong reduction of customer acquisition events after some time. The right hand side of Figure 5 shows the opposite but equally bad case. A focus on usage-based commissions with low customer acquisition commissions makes the time to break even extremely long. As a consequence, most franchises will stop operating before they ever hit the point where commissions from usage generate a sustainable revenue stream. The challenge is to find a commission structure between these two extremes that, on the one hand, provides sufficiently high customer acquisition commissions to support franchisees in their start-up phase, and that, on the other hand, pays sufficiently high usage-based commissions to sustain franchisees in the long run.

We observed this challenge while working on Drishtee's kiosk banking financial inclusion micro-franchising business. After the system had been running for about 8 months, an extensive analysis of the commission structure for kiosk owners revealed three major issues in the commission structure and the payout system:

- Strong focus on customer acquisition commissions: Calculating the monthly commission to franchisees versus the time since their establishment for an average franchisee revealed a graph that looked very much like the left hand graph in Figure 5. While a sustainable income level was, on average, reached after 2-3 months of operation, this was mostly driven by customer acquisition commissions. However, projections of market penetration development, customers retention and service usage predicted a dramatic drop in commission levels after 6-12 months of operation. After that the commission structure will likely become unsustainable for micro-franchisees.
- Unsustainable payout frequency/long delays before commission payout: It turned out that commissions had not been paid out for six months due to communication issues with the State Bank of India, which (as the franchisor) provides the back-end for this micro-franchising system. This had lead to low motivation among franchisees and some were becoming increasingly worried about their commissions.
- Missing transparency about commission amounts: The web-based kiosk banking interface employed did not allow Drishtee or its franchisees to see or even exactly calculate the commissions earned so far. Therefore, invoicing the bank for commissions became a problem, just as the intransparency about their own commission amounts was among the franchisees.

While the latter two problems have obvious fixes, the commission issue is much harder to solve, as just shifting commissions from customer acquisition to usage would most likely generate a gap during the start-up of franchises. In this case, the issue can probably only be solved by, on the one hand, passing on more money to franchisees from the side of the franchisor (in the form of usage-based commissions), and, on the other hand, by encouraging franchisees to engage in additional franchising model to increase their revenue base beyond this particular business model.

Use and Protect Your Brand

In traditional franchising in developed countries, sharing a common brand is one of the most important value propositions a franchising system can make to its franchisees. As brands can be seen as promises to deliver a certain quality, potential customers are likely to immediately grant new franchisees the same trust that they extend to the brand as a whole. This reduces the start-up phase for franchises considerably.

While brands in developing countries are not as strong as in the U.S. or in Western Europe, they may still help in overcoming the problem of initial lack of trust in the franchisee. Especially in businesses where trust is essential (healthcare or financial inclusion, for instance), operating under the name of a trusted brand can make the difference. A well-known brand will also help attracting franchisees. Franchisors that have a brand should, therefore, try to leverage it when promoting their micro-franchising system.

VisionSpring gives former farmers and workers a basic training in optometry before they become micro-entrepreneurs diagnosing eye-sight problems and selling reading glasses. New micro-franchisees may face credibility problems in their communities — Why should potential customers that have known them for years as farmers or workers trust that they have become real optometrists almost over night? To help their franchisees overcome such reservations, VisionSpring adds marketing material to each “business in a bag”: Brochures explaining the concept and the social intent of VisionSpring, certificates for the training courses that the franchisee has completed as well as posters and banners to present the VisionSpring brand prominently [3]. This is how VisionSpring leverages its brand among rural communities and hopes for word-of-mouth marketing as a channel to further spread their brand.

Drishtee also relies on brands and incorporates the brand name of the original franchisor when possible. For example, in their kiosk banking micro-franchising system that they run with the State Bank of India (SBI) as a back-end infrastructure provider, they make sure that SBI's logo is featured prominently on banners that franchisees display outside their kiosks. Furthermore, the identification cards Drishtee hands out to customers have the SBI logo on the front. As SBI is one of the largest (and most well-known) banks in India and run by the government, it is known and trusted also in rural areas. While Drishtee now probably also enjoys some brand recognition in the areas they serve, SBI's brand is far better suited to gain trust and respect among communities.

Just as working under a well-respected brand can be leveraged to gain trust and encourage business, using a brand without monitoring proper use and consistent quality can have devastating effects for the brand of the franchisor in the long term. Since the franchisor rarely sees the "end product" at the customer-facing side that the franchisee delivers, low quality or unethical behavior by franchisees may go undetected for extended periods of time. This potentially permanently ruins the reputation of the franchisor among a group of potential future customers. Ideally, the franchisee introduces some remote quality control mechanisms. However, this is very difficult to implement and we have not come across best practices other than paying franchisees a regular visit and monitoring their transaction data if possible. In any case, franchisors must be aware that they put their brands at risk to a certain extent by engaging in micro-franchising activity in remote areas.

It should be noted that, while the brand is generally seen as an asset for micro-franchising systems, in remote areas it may be a liability as well. Research by G. KISTRUCK et al. [18] suggests that strong brands may be seen as an indication for wealth. This in turn may create the expectation among franchisees that the franchisor has come to their rural community for purely charitable reasons, which entitles the franchisees to extract money from the franchisor.

Work with a Local Partner or Gain Local Knowledge

This misunderstanding about the role of the a franchisor is one of the reasons why it is essential for micro-franchisors to either work closely with local partners or to gain local knowledge themselves by hiring local employees. The knowledge of local partners or employees are a critical success factor for several reasons:

- The intention with which the micro-franchisor enters the area needs to be explained to the local community by someone who knows the community and speaks their language. Local leaders and respected people need to understand and buy into the idea behind the micro-franchising system.
- Local rules and regulations may significantly influence the way that micro-franchising business can be done in that area. Regulation may differ significantly between countries and states, even between villages, and often prevents the exact replication of the same micro-franchising model in other regions.
- Local habits and traditions are also very important to understand, especially if the business model targets at underprivileged groups such as lower social classes or women as franchisees.

Drishtee has its headquarter in Noida close to New Delhi, where strategy and business concepts are developed. Implementation and operation, however, is always done on a local level. In those states that Drishtee is active, Drishtee operates a regional headquarter as well as multiple local offices. Most of operations is done on a local level with sometimes little influence or oversight from headquarter. Regional managers spend a considerable amount of their time traveling to remote areas to stay in touch with Drishtee's franchisees and their local communities.

Select the Right Entrepreneurs

The question whom to recruit as an ideal micro-franchisee is very difficult to answer and not yet well understood [1], [18]. From our discussions with micro-franchisors we understood that there does not seem

to be an individual social group that consistently produces good micro-franchisees. However, there are some recommendations on what to look for when interviewing candidates.

Just as for any traditional start-up, good candidates must have a genuine passion for the business and the motivation to run it. This is a no-brainer. Furthermore, candidates must have at least some level of education that will allow them to understand and run the micro-franchising business. Drishtee has made the general observation that these two factors, passion/motivation and education, are usually found among people from a medium income level. On the one side, candidates from the very bottom of society very often lack even the most basic education and, while they may be most passionate as their motivation for upward movement in society as highest, their education level is often too low to train any management skills. On the other side of the income scale, people from high income families and village office holders are often too saturated to run a little business and may feel overqualified. The medium income group in rural areas, however, while already having some status within their society, is still eager to improve its social status. They become entrepreneurs neither because they have to due to lack of alternatives—as the lowest social groups would—nor because they see entrepreneurship as a playing field—as the higher income groups would. Research suggests that exactly that kind of “opportunity entrepreneurship” contributes positively and significantly to economic development [2].

The fact that high income groups are not necessarily good entrepreneurs became evident, for instance, in 2000 when Drishtee was looking for franchisees for their new micro-franchising model: Computer education centers. At that time the necessary investment per computer was 70,000 Indian rupees (roughly US \$1,700) and so Drishtee’s offering attracted mainly young men coming from wealthy families. As their social status was already relatively high, it turned out that their passion for running a computer education business was low. Instead, their real motivation was to play games on the computers they bought for their education center and to show off their business to gain the respect of others. As a consequence, they quickly lost interest in their business and Drishtee was neither able to create social value for communities they were aiming for, nor the profits they hoped to gain.

Another quality that micro-franchisors should keep in mind is that micro-franchisees often need to be able to create a market in their local communities. As micro-franchising often brings products or services to remote areas that previously were not available or affordable, there is often no market that franchisees can tap into. In order to be successful, franchisees need to go out and create demand. Franchisors will need to support that person (e.g. by providing free samples or assisting with promotional campaigns), but in the end it is the personality of the franchisee and the respect that he or she enjoys that decides whether they are able to create their market. In most cases this also implies that the person has to be a local in the respective sales area.

A strategy employed by South African mobile phone operator Vodacom to find potential micro-franchisees was to approach highly connected and active people. Vodacom provides cell phone and fax services to the poor in South Africa in a micro-franchising system where kiosks are set up by Vodacom and then operated by a micro-franchisee. To find the active and highly connected people, Vodacom tracked down the owners of cell phones with unusually high call volume and asked them whether they were interested in running a kiosk [19]. Similar strategies could be employed with other products and services as well.

As a final anecdote: A couple of years ago, Drishtee tried to identify good entrepreneurs by subjecting candidates to a psychometric test developed by a specialized consultancy. However, that approach proved to be not helpful. Instead, the founder of Drishtee as well as some other successful entrepreneurs failed this test. After that, Drishtee returned to relying on personal interviews again.

Be prepared to adapt constantly

Few micro-franchising businesses will work perfectly from the start. Even if considerable time has been spend on the concept, the unpredictability and the constant change of the environment in developing countries makes it extremely unlikely that a micro-franchising systems works perfectly as envisioned right from the beginning. Therefore, the micro-franchisor must be prepared to constantly adapt the sys-

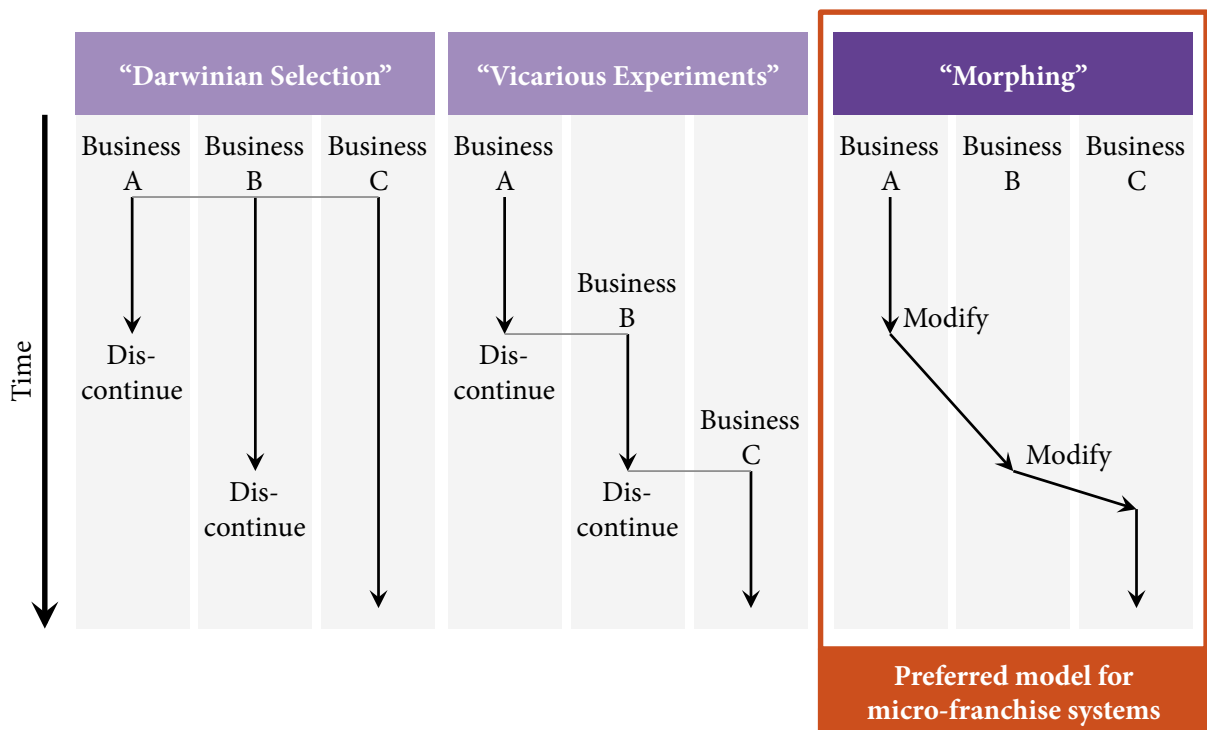


Figure 6: Illustration of three approaches on how to deal with uncertainty about what business models and procedures work. Under a “Darwinian Selection” approach (left), multiple different models are started and discontinued if necessary. Employing the “Vicarious Experiments” method (middle) means to launch and discontinue new businesses (under different names) until a working one is found. Under the “Morphing” approach (right), one business model is launched but gets constantly adapted (keeping its name) until it is found to be effective and efficient. Micro-franchisees should employ the “Morphing” approach. Illustration adapted from [17].

tem and processes to match unforeseen new conditions. The franchisor must be prepared both mentally as well as from a resource point of view. It is critical to not dismiss the team after the micro-franchising concept has been developed, but to keep them permanently to have knowledgeable resources available once changes need to be made.

When changing a business model or the way it is operated, there are three approaches available, as illustrated in Figure 6. The first approach could be called “Darwinian Selection” (left chart in Figure 6) and, applied to a micro-franchising environment, would be to launch and operate a whole range of different micro-franchising models at the same to find the one that works best. However, this is very difficult to achieve in micro-franchising. First, the unpredictability of the environment makes it very difficult to identify all potential options upfront, including the one that will eventually work best. Second, since micro-franchisors are often constraint both in terms of resources and in terms of available micro-franchisees, launching multiple models at the same time for similar businesses is not a feasible approach in this environment. The second approach—“Vicarious Experiments” (middle chart in Figure 6)—is to launch one business model and observe. If it is not successful, it is discontinued and an improved business model is launched under a different name. This continues until a working business model is found. This approach is also not favorable for micro-franchising businesses due to the strong binding between the business and its franchisees. It would be very hard to explain franchisees repeatedly why they have to switch their name and business model. The last approach—“Morphing” (right chart in Figure 6)—is to silently adapt a business until it works. This is the approach that is best suited for a micro-franchising

environment, as it allows to easily keep existing franchisees on board while gradually optimizing the business and its operations.

When making changes to a micro-franchising business or its operations, trial-and-error is the best possible approach. Due to the lack of market research data on most rural areas in developing countries, it is often very hard to make decisions based on raw analysis. Intuition and experience need to be combined with the few available data points to select the most promising approach. In the end, however, usually only a trial run will determine whether the selected approach actually works.

Focus on Simplicity and Efficiency

As mentioned earlier, the typically rudimentary level of education among franchisees and customers makes a simple and easily understandable business essential. Furthermore, complex processes are prone to errors, which are difficult to detect and correct in remote areas. When devising a business or when changes to the business or its operations are made, franchisors should hence ask themselves two questions for every change:

- Does this change make the business or its operations simpler? If not, can we modify the change to make it simpler while achieving the same effect?
- If we cannot make it extremely simple, how can we codify the new concept in the most easy-to-understand way?

If changes cannot be made in a simple and easily explainable way, there must be a really good reason to implement them in spite of the complexity. Some business models are inherently complex (healthcare offerings, for instance). In such cases, clear documentation is essential and additional financial incentives for the franchisee to comply with the operational guidelines recommended [3].

Similarly, when making changes, improving efficiency should be a second major concern. Micro-franchisors often make the mistake of de-prioritizing efficiency in favor of quickly gaining scale. As a consequence, new franchisees are added at a very fast rate, while the original infrastructure, which was initially set up for a small number of franchisees, becomes less and less appropriate. This behavior is typical and understandable as scale is a profitability driver in micro-franchising. However, at some point the efficiency of the infrastructure has to be improved as well.

We observed this effect while analyzing Drishtee's kiosk banking financial inclusion business and their FMCG supply chain network. In both cases, priority had been given to extending the network of franchises over operational improvements. This is understandable for both businesses from the way the commission structure worked in the case of financial inclusion and in order to build up purchasing power against suppliers for the FMCG distribution network. However, at some point in time the processes and policies in place were no longer appropriate for the size of the franchise networks. Both businesses started to exhibit working capital issues and in both cases more or less simple changes to processes were recommended to address the problems (to be implemented over the course of the coming months).

Replace legal fine print with incentives

Our final recommendation is to not rely too much on contracts between micro-franchisor and micro-franchisees. Complex contracts and especially fine-print should be avoided. First, contract enforceability in developing countries is often very limited. For instance, India, home to many micro-franchising systems, in 2010 ranked #182 out of 183 countries in terms of contract enforceability (behind war-torn Angola) [20]. In India it takes about three times as long to enforce a contract and costs about twice as much as in an average OECD country. Second, franchisees may see fine print in legal documents as a sign of mistrust and/or do not understand them.

Therefore, only the most basic and important rules should be included in a contract. All other rules and responsibilities of the franchisee should only be documented. Instead of contracts, incentives should be used to encourage compliance. While monetary incentives often work best, other forms of incentives

can be used as well. For example, the most compliant franchisees can be highlighted in an internal (e.g. newsletter) or in an external publication (e.g. web site), which increases their prestige.

Aligning the interests of business partners to elicit a certain behavior is always preferable over legally enforcing that behavior via contracts. In micro-franchise environments, this is even more true than for regular businesses in developed countries.

7 Conclusion

Micro-franchising will most likely not become the silver bullet for poverty alleviation. Nevertheless, we are confident that it can play a significant role in creating businesses and, hence, employment at the base-of-the-pyramid. It provides micro-entrepreneurs with a proven business model and the chance to profit from the best practices of hundreds or thousands of other micro-entrepreneurs, as well as from the purchasing power and scale of the franchisor. Micro-franchising allows franchisees to focus their efforts on a small market, without the need to set up and operate expensive back-end infrastructure. Still this concept is able to bring new products and services to remote areas that would otherwise be not available at all or at least not affordable.

For enterprises this model provides the chance to penetrate potentially untapped markets that would otherwise not easily be accessible, while having some social cause for doing it. However, companies should be advised to select their micro-franchise businesses carefully as the model only works for simple business models and products in certain market environments. Also there is a considerable amount of work to be done after the micro-franchising infrastructure has been set up. A micro-franchising system is by no means a fire-and-forget rocket—it needs constant supervision and a high level of maintenance. But given the right resources and managed well, building up a micro-franchising network might pay off in the future: A great brand among the rural population with legions of loyal customers and knowing that one probably helped hundreds or thousands of families making their first step towards a better life by giving them the opportunity to become an entrepreneur.

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