Micro-Franchising: Application and Success Factors

Tobias Hürlimann
September 29, 2011
Agenda

Drishtee in Rural India
Introduce the environment in rural India, explain Drishtee’s approach and show some examples of Drishtee’s work

Micro-Franchising
Present a framework to assess micro-franchising opportunities, determine required infrastructure and learn about success factors

My Internship
Give you an impression of the work during my summer internship at Drishtee
Agenda

**Drishtee in Rural India**
Introduce the environment in rural India, explain Drishtee’s approach and show some examples of Drishtee’s work

**Micro-Franchising**
Present a framework to assess micro-franchising opportunities, determine required infrastructure and learn about success factors

**My Internship**
Give you an impression of the work during my summer internship at Drishtee
Drishtee operates in rural India – an environment with low income, low education and weak infrastructure

### A Typical Indian Village in Numbers

- Average population: 6,200 people
- Main occupation: Agriculture (60%)
- Literacy rate: 52%
- Households electrified: 26%
- Average electricity/day: 4 hours/day
- Telephone penetration: 12%
- Bank accounts: 10%
- Loan defaulters: 60%
- **Average rural family earns less than $70 a month**

Source: Drishtee
Drishtee provides rural micro-entrepreneurs with a business model and all necessary infrastructure

Value Proposition:
- **Access to New Markets**

**Companies**
- Government
- Financial Services
- Consumer Goods
- Healthcare
- ...

**Drishtee**
- Manufacturing of goods, Back-end infrastructure
- Business Model, Training, equipment, financing, processes

**Micro-entrepreneurs**
- Entrepreneur 1
- Entrepreneur 2
- Entrepreneur 3
- Entrepreneur 4
- ...

**Customers**
- Village 1
- Village 2
- Village 3
- Village 4
- ...

Value Proposition:
- **Access to “New” Services/Goods**

Value Proposition:
- **Sustainable Business Model; Empowerment & Employment**
Example Financial Inclusion: Basic banking services provided by one-man bank branches in small huts

<table>
<thead>
<tr>
<th>Problem</th>
<th>Drishtee’s Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ 51.4% of farmer households do not have access to basic financial services and adequate credit</td>
<td></td>
</tr>
<tr>
<td>▪ Bank branches often miles away (take hours or longer to reach)</td>
<td></td>
</tr>
<tr>
<td>▪ The poor often cannot afford the minimum deposit of a regular savings account</td>
<td></td>
</tr>
<tr>
<td>▪ Micro-entrepreneurs run one-man bank branches</td>
<td></td>
</tr>
<tr>
<td>▪ Access to checking accounts and micro-credit</td>
<td></td>
</tr>
<tr>
<td>▪ Back-end banking infrastructure provided by large Indian bank</td>
<td></td>
</tr>
<tr>
<td>▪ Hardware used:</td>
<td></td>
</tr>
</tbody>
</table>
  ▪ Computer or Netbook |
  ▪ Biometric scanner |
  ▪ Wireless internet access |
  ▪ Digital Camera |
  ▪ Printer |

Source: Report of the Committee for Financial Inclusion (2008), Field Trip to Assam; Drishtee
**Example FMCG Distribution: Distribution to rural shops and kiosks using an auto truck**

<table>
<thead>
<tr>
<th>Problem</th>
<th>Drishtee’s Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Normal distribution doesn't reach rural areas</td>
<td></td>
</tr>
<tr>
<td>- Rural shops buy products from big shops at town or hub villages</td>
<td></td>
</tr>
<tr>
<td>- They don't get full retail margin as wholesalers keep a portion of it</td>
<td></td>
</tr>
<tr>
<td>- They have to travel to buy products.</td>
<td></td>
</tr>
</tbody>
</table>

- **Drishtee Warehouse**
  - Drishtee procures various products
  - Storage in Drishtee’s district warehouses

- **Drishtee Truck**
  - An auto-riksha truck is loaded with goods
  - One truck covers 40 shops a day on a 30 miles trip

- **Shops**
  - Shopkeepers buy goods when Drishtee truck stops by their shop

Source: Field Trip to Assam; Drishtee
Agenda

**Drishtee in Rural India**
Introduce the environment in rural India, explain Drishtee’s approach and show some examples of Drishtee’s work

**Micro-Franchising**
Present a framework to assess micro-franchising opportunities, determine required infrastructure and learn about success factors

**My Internship**
Give you an impression of the work during my summer internship at Drishtee
Franchising well-known tool in developed countries to provide a proven business model to entrepreneurs

Advantages of Traditional Franchising

- Provides entrepreneurs a proven and successful business model
- Enables companies to extend their market reach without large capital expenditures
- Alignment of incentives reduces agency concerns
Micro-Franchising is the application of franchising to poor and underserved areas with a social component.

- **Advantages of Traditional Franchising**
  - Provides entrepreneurs a proven and successful business model
  - Enables companies to extend their market reach without large capital expenditures
  - Alignment of incentives reduces agency concerns

- **Additional Advantages for Micro-Franchising**
  - Entrepreneurship opportunities for poor people
  - Provides Access to new products/services to underserved villages and remote rural areas
  - Empowerment of weak social groups (e.g. women, lower class/lower caste persons)
Framework to assess opportunities, determine needed infrastructure and key success factors

1. Characteristics of Businesses Best Suitable for Micro-Franchising

2. Infrastructure Requirements

3. Success Factors for Micro-Franchising Systems
Framework to assess opportunities, determine needed infrastructure and key success factors

<table>
<thead>
<tr>
<th>Characteristics of Businesses Best Suitable for Micro-Franchising</th>
</tr>
</thead>
<tbody>
<tr>
<td>Existence of an Access Problem</td>
</tr>
<tr>
<td>Standardized Features &amp; Pricing</td>
</tr>
<tr>
<td>Easy to Understand and Sell</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Infrastructure Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Train and Educate Entrepreneurs</td>
</tr>
<tr>
<td>Provide Standardized Equipment</td>
</tr>
<tr>
<td>Provide Supply Chain and Processes</td>
</tr>
<tr>
<td>Provide Financing</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Success Factors for Micro-Franchising Systems</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregate Businesses</td>
</tr>
<tr>
<td>Select the Right Entrepreneurs</td>
</tr>
<tr>
<td>Employ a Sustainable Commission Structure</td>
</tr>
<tr>
<td>Be Prepared to Adapt Constantly</td>
</tr>
<tr>
<td>Use and Protect Your Brand</td>
</tr>
<tr>
<td>Focus on Simplicity and Efficiency</td>
</tr>
<tr>
<td>Work with Local Partner or Gain Local Knowledge</td>
</tr>
<tr>
<td>Replace Legal Fine Print with Incentives</td>
</tr>
</tbody>
</table>
Framework to assess opportunities, determine needed infrastructure and key success factors

### 1. Characteristics of Businesses Best Suitable for Micro-Franchising

- Existence of an Access Problem
- Standardized Features & Pricing
- Easy to Understand and Sell

### 2. Infrastructure Requirements

- Train and Educate Entrepreneurs
- Provide Standardized Equipment
- Provide Supply Chain and Processes
- Provide Financing

### 3. Success Factors for Micro-Franchising Systems

- Aggregate Businesses
- Employ a Sustainable Commission Structure
- Use and Protect Your Brand
- Work with Local Partner or Gain Local Knowledge
- Select the Right Entrepreneurs
- Be Prepared to Adapt Constantly
- Focus on Simplicity and Efficiency
- Replace Legal Fine Print with Incentives
# Agenda

<table>
<thead>
<tr>
<th>Drishtee in Rural India</th>
<th>Introduce the environment in rural India, explain Drishtee’s approach and show some examples of Drishtee’s work</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro-Franchising</td>
<td>Present a framework to assess micro-franchising opportunities, determine required infrastructure and learn about success factors</td>
</tr>
<tr>
<td>My Internship</td>
<td>Give you an impression of the work during my summer internship at Drishtee</td>
</tr>
</tbody>
</table>
Drishtee Internship Timeline: Worked on four different topics over the summer

<table>
<thead>
<tr>
<th>June 2011</th>
<th>July 2011</th>
<th>August 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Drishtee’s “One-man Bank Branch” Business</td>
<td>FMCG Distribution Business</td>
<td></td>
</tr>
<tr>
<td><strong>Cash Management:</strong> Developed methods to reduce the problem of cash accumulation at rural one-man bank branches</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Field Visit to Assam</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Commission Structure:</strong> Analyzed long-term sustainability of current commission structure for Drishtee and its franchisees</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Truck Loading:</strong> Optimized Truck Loading Efficiency</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Designed User-Interface for a Mobile Point-of-Sale Application</td>
</tr>
</tbody>
</table>
An “Aggregator” like Drishtee helps making micro-franchising sustainable

**Problem**

Revenues from one micro-franchising business often not sufficient to sustain the micro-entrepreneur’s business

**Recommendation: Aggregate Multiple Micro-Franchising Systems**

**Micro-Franchisors**
- Provide goods or back-end services
  - Franchisor 1
  - Franchisor 2
  - Franchisor 3
  - ...

**Micoro-Franchisees**
- Run multiple franchising businesses
  - Franchisee 1
  - Franchisee 2
  - Franchisee 3
  - ...

“Aggregator”
- Training
- Equipment
- Financing
- Supply Chain & Processes

Gain access to more franchisees

More revenue due to multiple income sources
At Drishtee, commission structure too focused on customer acquisitions

**Problem: Commissions Unsustainable**

- For service-based micro-franchising systems, **commission structure should provide sustainable revenue during start-up phase and in later phases**
- At Drishtee, commission projections from current commission structure looked like this:

**Recommendation: Balance Commissions**

- **Ensure a more balanced distribution** of commissions between customer acquisition and usage-based fees
- In total, commission may **still be below sustainable income level**, but this can be alleviated via business aggregation
When deciding on truck loading, past sales performance not considered

**Problem: Inefficient truck loading**

- Local managers decide what to load onto the trucks used for FMCG distribution to small rural shop and kiosks.
- Analysis of the truck loading efficiency revealed suboptimal behavior:

  - Past sales performance
    - SKUs that sold out last time
    - SKUs that did not sell at all last time
  - Typical observed behavior
    - Same quantity next time
  - New default behavior
  - Increase quantity next time
  - Reduce quantity next time

**Recommendation: Consider past sales**

- Consider past sales performance when deciding about loading of SKUs.
- Drishtee’s intranet system to make an automated recommendation on what to load on the trucks:

  - Past sales performance
    - SKUs that sold out last time
  - Same quantity next time
  - SKUs that did not sell at all last time
  - Same quantity next time
Thanks!

**Thanks, Drishtee…**
- Deependra Solanky
- Geeta Sangha
- Satyan Mishra
- Nitin Gachhayat
- Sudhir Gupta
- KB Singh

...for giving me an interesting and meaningful internship!

**Thanks, CRTI…**
- Mohan Sawhney
- Parminder Sawhney

...for making all this possible!

**Thanks, CRTI Fellows…**
- Asha Rao
- Ben Neuwirth
- Bryan Lee
- Jen Helms
- Sara Lo

...for the great time we had in India!
Backup
Not all businesses are equally suitable for micro-franchising

### Characteristics of Businesses Best Suitable for Micro-Franchising

<table>
<thead>
<tr>
<th>Suitable Business Model</th>
<th>Suitable Market Environment</th>
<th>Suitable Product</th>
</tr>
</thead>
</table>
| - Value chain with high CapEx/OpEx requirements in non-customer-facing parts/back-end | - Existence of an access problem for a customer group or area: next best alternative is  
  - Technically inferior  
  - More expensive  
- High cost structure in customer-facing part for traditional sales channel (e.g. shops, branches) | - Simple and easy  
  - Easy to understand  
  - Easy to sell  
  - Easy to use |
| - Low cost structure for customer-facing activities possible if done by micro-entrepreneurs | - Demand too low for traditional sales channels to be profitable, but high enough to support micro-entrepreneur | - Standardized features  
- Standardized pricing |
Once a business model has been selected, the franchisor needs to provide infrastructure.

### Infrastructure Requirements

**Train and Educate Entrepreneurs**
- Training since most micro-entrepreneurs have no formal business education
- On-going education about changes and best-practice sharing

**Provide Supply Chain and Processes**
- Micro-entrepreneur does not have the capacity and capital to set up any back-end processes
- Interface between franchisor and franchisee needed for e.g. service delivery, reordering

**Provide Standardized Equipment**
- Micro-entrepreneurs often cannot evaluate what equipment works best for them
- Standardized processes and consistent customer experience require standardized equipment

**Provide Financing**
- Franchisor must provide start-up capital or pre-negotiated deal with micro-credit company
- CapEx, working capital and recurring charges/fees must be pre-financed
Success of micro-franchising system mainly depends on several key success factors:

**Success Factors for Micro-Franchising Systems**

- **Aggregate Businesses**
  - Revenue from one MF business often not sufficient
  - Bundle multiple MFs

- **Sustainable Commission Structure**
  - Avoid focus on either customer-acquisition or usage-based commissions

- **Use and Protect Your Brand**
  - Brand can help overcome reservations
  - Quality control to protect brand

- **Local Partner or Local Knowledge**
  - Local regulations and traditions need to be understood
  - Not possible from HQ

- **Select the right Entrepreneurs**
  - Need passion and some education
  - Middle income class often best suited

- **Be Prepared to Adapt Constantly**
  - No MF system perfect from start
  - Constant “morphing” of business required

- **Focus on Simplicity and Efficiency**
  - Only simple processes viable in rural areas
  - Do not forget efficiency over growth

- **Replace Legal Fine Print with Incentives**
  - Contracts not understood, fine print seen as sign of mistrust
  - Use incentives instead
# Micro-Franchising versus Micro-Credit, Micro-Consignment and Donations

<table>
<thead>
<tr>
<th></th>
<th>Donation</th>
<th>Micro-Consignment</th>
<th>Micro-Franchising</th>
<th>Micro-Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Risk for Entrepreneur:</strong></td>
<td>None</td>
<td>Low</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td><strong>Delivers Proven Business Model:</strong></td>
<td>✗</td>
<td>✓</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td><strong>Purpose:</strong></td>
<td>Ensure survival</td>
<td>Creating entrepreneurial opportunity with a well-defined, proven business model</td>
<td>Seed capital for individual business</td>
<td></td>
</tr>
</tbody>
</table>
Value Chain Criteria for Suitability of Business Models for Micro-Franchising

Front- and Back-end value chain steps are separable (do not necessarily need to be performed by the same company)

Other value chain steps

Non-customer facing activities

Back-end step 1
Back-end step 2
…

Back-end value chain steps

Customer-facing activities

Front-end step 1
Front-end step 2
…

Front-end value chain steps

Required CapEx/OpEx Investment:

High

Traditional channels: Medium to High
Micro-Entrepreneurs: Low
Examples of Micro-Franchising Types along the Value Chain

Non-customer facing activities

- Raw materials
  - Hunter, Gatherer, Farmer

- Production
  - General Product Franchise
  - Kit Assembly
  - Owner Operator
  - Specialized Equipment Operator

Customer-facing activities

- Sales
  - Sales Agent
  - Local Promoter
  - Financial Inclusion Franchise

- After Sales
  - Field Service Technician