Enhancing Development In Africa

FRANCHISING REPORT

The African Development Bank Group

PRIVATE SECTOR DEPARTMENT

Executive Summary

Chapter 1, Background to the Study, reviews the Terms of Reference and methodology of the study. The objective of the African Development Bank is to increase economic development by mobilising and enlarging investment flows to the African continent by such means as private sector development. Small and Medium Enterprises account for over 90% of private businesses. The franchising model of business is a useful tool for promoting SME development and increasing private sector development throughout Africa. International experience has shown that franchising contributes to poverty reduction and wealth creation.

The Terms of Reference stipulated twelve (12) objectives. The objectives have been attained through analysis of empirical data gathered from primary research by means of interviews with individuals in all levels of franchising in four (4) target countries, as well as with bankers, lawyers, management consultants and donor agency representatives in the target countries and elsewhere. Secondary research has been conducted through review of extant academic literature on the subject and various web sites.

Chapter 2, Franchising, introduces basic definitions as well as a framework of understanding of the business principles and practices known as franchising. The research has postulated that franchising is a "business strategy" and, like any business strategy, it is designed to maximize market share and minimize risk for its participants. In this case the participants are both franchisors and franchisees. Franchisors and franchisees act as de facto "strategic partners" of independent SMEs acting in a symbiotic relationship, with specific roles to play and responsibilities and obligations to each other. This contractual and philosophical conjoining of resources between SMEs in a franchise system creates systemic synergies wherein the "whole is greater than the sum of its parts." Notwithstanding the notion of a "strategic partnership," the intellectual property belongs to the franchisor and is licensed to franchisees for a limited period of time and under certain terms and conditions. In order to protect the integrity of that intellectual property, the franchisor reserves broadly sweeping rights and privileges in its franchise contracts with its franchisees. The Rule of Law is therefore critical to maintaining and protecting the franchisor's ownership of its intellectual property. Without it, the could-be franchisor will have absolutely no interest in teaching a potential competitor his proven trade secrets. This introduces a basic paradox between ownership and control of the intellectual property, protected and enforced by the Rule of Law, versus protecting and enhancing the integrity of the relationship between franchisors and franchisees. It is the interpretation and understanding of this paradox that constantly challenges the judiciary, legislators, and business and professional bodies.

A franchise system evolves through three (3) distinct stages: emerging, mezzanine and mature. Business risk is generally highest at the beginning of the business cycle and declines as the franchise system matures. Business risk is highest at the emerging franchisor stage of growth due to a number of contributing factors. These factors include, among others, the emerging franchisor's difficulty in changing its operational behaviour and management style from that of a "retailer" (or one who owns and operates one or more retail businesses) to that of a "management consultant" (a franchisor) teaching others (franchisees) how to be retailers; the emerging franchisor's limited knowledge of proven franchise principles and practices (or "best practices"); and the fact that most, if not all of these best practices exist only anecdotally and therefore do not exist in a form that may be readily taught to others. In addition, inadequate technical knowledge regarding the causal relationships between franchise system expansion, operational support, and cash flow undermines the emerging franchisor's ability to manage its working capital and thereby increasing the risk of financial failure. Increased business risk has a correlating impact on any commercial lender's credit risk assessment. However, this risk may be alleviated through technical and managerial development, or capacity building initiatives. Hence, any franchise financing strategy must consider capacity building initiatives as a key component to mitigating lending risk.

A clear understanding of franchising "best practices" fosters a common understanding of the nature and dynamic of franchising. This, in turn, facilitates further analysis and measurement; supports the development and implementation of professional development or capacity building programs targeted at various directly and indirectly related parties; and supports the view that financial and other incentives used to foster franchising in Africa should be specifically designed to encourage and maximize the use of "best practices" amongst franchise systems.

Chapter 3, Status of Franchising Internationally, presented an examination of the historical implementation of franchising internationally. By so doing, certain patterns of development experienced in other countries were identified and placed into a context that might prove useful for the growth of franchising in Africa.

Observations of international franchisors operating in emerging countries shows that not only geographic, but also cultural distance can be successfully crossed through cultural sensitivity and environmental adaptation of a franchise system's products. The adaptation of local products has been seen to enhance the integrity of the brand in host countries while in no way compromising the effectiveness of the operating system or the on-going support function. This international experience suggests that the cultural diversity existing in Africa should not prove to be an insurmountable barrier to entry for international franchise systems.

Environmental factors such as the extent of corruption and the Rule of Law, income per capita, urbanisation and literacy were compared and contrasted between high income, middle and low income economies and their relative degree of franchise development in order to identify certain predictable corollaries. The analysis confirmed a positive correlation between the existence of franchising and the Rule of Law, income per capita, urbanisation and literacy and an inverse correlation between franchising and corruption. However, Indonesia and Russia were two notable exceptions in that they are both generally considered to be strong franchise markets in spite of high rates of corruption and low effectiveness of the Rule of Law. Significantly, the articles reviewed on this matter suggested that a possible explanation for this seemingly counter-intuitive behaviour is that the markets were simply too big for franchisors to ignore. This behaviour suggests that franchisors may be prepared to expose themselves to a higher than normal environmental risk if the market potential and financial return is also perceived to be high.

There was also found to be a high correlation between the prevalence of franchising in a given country and the existence of a national franchise association. Franchise associations were found to serve useful roles to its members in five areas: to lobby the public sector in areas of relevance to franchising, promote the credibility of its membership to the public, provide networking opportunities and professional development programs to its members and market and promote its members within its own country and eventually abroad.

They are also the best-suited organisation for representing the interests of franchisors and franchisees versus other related sectors such as local commercial lending institutions, professional bodies such as lawyers, public accountants and management consultants, supplier groups and relevant public sector departments.

Franchise-specific legislative regulation appears to be a slowly growing trend internationally in response to two factors: reported abuses of franchisees by the franchisors and the lack of an adequate body of common law precedents within which to interpret and adjudicate franchise disputes. The first point tends to occur more often in mature franchise economies while the second point tends to be applicable to emerging economies. Hence, as the latter point is more generally applicable to the African environment, franchise regulation is therefore considered to be helpful in promoting best practices in franchising.

Examples of financing programs applicable to franchising were reviewed and discussed in relation to their potential applicability to the African context. Franchise financing programs tended to be collateral asset based lending with one exceptional program being observed as cash flow based. All of the lending programs were limited to mature, or at least mezzanine level franchise systems with a strong historical track record of operational success. Each financial institution instituted lending limits by franchise system so as to maintain a balanced portfolio and minimise its credit risk exposure with any one franchise system. Loans were secured by various means including personal guarantees from franchisees; letters of comfort from franchisors and government guarantees. Bad debts, net of calls on any loan guarantees, were reported as averaging less than 2%. Where loan defaults for a given franchise system exceeded a certain nominal percentage; a moratorium was placed on further lending to that franchise system. These examples of franchise financing programs thereby serve as useful precedents upon which African-based initiatives may be based.

Use of the government sector to promote and protect the export of domestic franchise systems was also noted. Governments of AfDB donors from certain developed economies use their embassies and consulates effectively to promote domestic franchise systems expanding internationally. In addition, these same governments offer export insurance and other forms of assistance programs designed to mitigate the risk associated with international expansion.

Finally, there was a broad correlation noted between the amount, quality and consistency of data related to franchising available for study and the level of franchise development in a given market. Collection of statistics pertinent to franchising would provide a useful tool for potential investors, academics and policy makers.

Chapter 4, Environmental and Structural Issues Affecting Franchising in Africa, presents the results of secondary research that analyses the impact of certain environmental factors on foreign direct investment. The most significant of these environmental factors include the extent of corruption, the effectiveness of the judiciary, infrastructure, access to financing, inflation, and crime rates. Interviews conducted in the course of this research supports the view that international franchisors are equally influenced by the above noted factors. In addition, research conducted by the World Bank Group - SME Department suggests that SMEs suffer even more than international businesses from poor business enabling environments.

A related AfDB report classifies fifty-one (51) African countries according to various levels of financial development (high, moderate and least developed) and macroeconomic stability (stable, marginally stable, unstable and highly unstable). Varying degrees of franchise activity were found to exist in 22 of the countries listed thereby providing prima facie evidence to support the view that franchising could function effectively in Africa. Similar to Chapter 3, environmental factors such as the extent of corruption and the Rule of Law, income per capita, urbanisation and literacy were compared and contrasted between African countries with evidence of franchising, those with sufficiently stable environments to potentially support franchising and those that may be considered not environmentally conducive to franchising at this time. The analysis generally confirmed a positive correlation between the existence of franchising and the Rule of Law, income per capita, urbanisation and literacy and an inverse correlation between franchising and corruption. However, as in the case of Russia and Indonesia, franchising was also observed to exist in African countries where environmental conditions would not normally be considered conducive to franchise growth. This pattern of development is therefore consistent with that of international franchisors who were observed in Chapter 3 as being prepared to tolerate a degree of environmental risk if the market opportunity is perceived to be sufficiently attractive. Certain other countries that may otherwise appear attractive from a political, economic or a financial development perspective are constrained by limitations in their absolute market potential. Hence, it is unlikely that the smaller countries will develop or support viable franchisor businesses under the current circumstances. However, there is evidence that these smaller markets may support a limited number of franchisee locations that may be serviced and supported from larger markets nearby. A central issue to stimulating further franchise development in Africa therefore lies in how one may effectively leverage existing strengths while minimising the obvious constraints.

Chapter 5, Analysis of Franchise Sector in Africa, presented primary and secondary research regarding the existence and effectiveness of franchising in Africa. In summary, franchising was found to be the most developed in South Africa, followed by Egypt and Morocco respectively. While evidence was obtained to suggest that franchising existed in 19 additional African countries, quantifiable information does not exist with regards to the number of franchise systems, including franchisors and franchisees, the distribution by sector or any other relevant data. This lack of accurate data undermines the ability of policy makers and academics to develop an accurate understanding of the impact franchising currently has, or could have, in Africa.

An evaluation of the relative strengths and weaknesses of a selected sample of franchise systems in the survey countries were analysed and compared to generally accepted "best practices" in franchising. South African franchise systems provide persuasive evidence of a thriving, self-sustaining community with distinct patterns of growth and influence throughout the rest of the African continent. While international franchise systems were found to have made a significant contribution to SMEs in the countries surveyed, African franchise systems appeared to possess a higher propensity to yield sustained, long-term economic value in the continent. It was also shown that franchising contributes to good corporate governance, transparency and the conversion of the informal sector to the formal sector through certain standard contractual terms used in franchise agreements. There was sufficient evidence to support the view that South Africa could be utilised as a strategic platform to develop and expand the use of franchising in Africa.

Conversely, areas of weakness include the limited existence or use of management information systems (versus operational systems), a general lack of understanding of franchising "best practices" amongst the general population, government ministries, lawyers, public accountants and financial institutions (especially outside of South Africa) and financial lending instruments more suited to entrepreneurs with low levels of investment capital. There is also a need to identify and develop a greater number of franchise concepts that specifically cater to rural and low demographic consumers.

Capacity building initiatives, including public relations campaigns, may be utilised to promote the application of franchising to formal and informal business activities currently existing in rural environments. In addition, financing programs designed specifically for franchise systems can play a critical role in funding sector growth.

Chapter 6, International Franchising in Africa, evaluates the role international franchise systems have had in Africa and explores the means by which further importation of international franchise systems may be encouraged.

There is sufficient evidence to support the view that international franchisors have made a significant contribution to the development of franchising in Africa to date. However, this contribution is clearly and strictly limited to politically and economically stable environments with a certain minimum degree of urbanisation and demographic viability. International franchisors have been generally observed to serve as a stimulus, rather than an inhibitor to the growth of indigenous franchising in host countries, especially in emerging markets. This indirect transfer of knowledge has often contributed positively to a thriving franchise community in these markets.

Generally, international franchisors perceive Africa unfavourably compared to other emerging markets when making resource allocation decisions relating to strategic expansion. However, these same franchisors may be convinced to consider the opportunity in the event they are directly approached by a well-qualified potential master franchisee. Attracting the best-qualified franchise systems therefore requires a more aggressive, proactive approach on the part of African-based entrepreneurs and its governments.

Incentives to attract foreign franchise systems may be considered worthwhile; assuming international franchisors are experienced in international expansion, have a proven track record of previous accomplishments and a clearly substantiated human and financial resource base. African governments can assist this process by developing market research packages by sector, identifying and distributing lists of potential master franchisees, and interfacing with foreign governments on trade missions and other programs designed to introduce international franchisors to possible master franchisees. Any export insurance and financing assistance programs made available directly or indirectly through public or developmental funds to franchisors or their various forms of licensees should be conditional on the inclusion of certain contractual obligations acting as preventive controls designed to minimise the risk of financial loss to the borrowers and, by probable extension, the lenders.

In Chapter 7, The Contribution of Franchising to Economic Development in Africa, the economic contribution of franchising was evaluated within the African context as a means of technology and know-how transfer. Technology and knowledge transfer is evidenced by training and regular support provided by franchisors. It was determined that the benefits derived from technology and knowledge transfer equal the costs to obtain them.

Surveys conducted in the target countries observed that franchising creates both direct and indirect employment and increases the skill level of the employment force. Franchising is also noted to have a positive contribution to export earnings and foreign exchange earnings as international franchisors repatriate a percentage of franchise fees and royalty revenues earned by franchisees, area developers, master franchisees or subsidiary corporations pursuant to its licensing arrangements.

Overall, in its ability to create employment, thereby alleviating poverty, franchising was considered to be compatible with the goal of sustainable development in Africa. The most tangible contributions of franchising to economic development seem to be the generation of entrepreneurship and employment, as well as the development of the small and medium enterprise (SME) segment of the private sector. Franchising may therefore be designated within a development strategy focusing on small and medium enterprises.

Chapter 8, The Legal and Regulatory Framework of Franchising in Africa, evaluated the legal and regulatory environments in Africa as well as the effectiveness of the judiciary and its enforcement capabilities. The evaluation was based on surveys conducted in the target countries: South Africa, Egypt, Morocco and Côte d'Ivoire.

The research indicates that there is no franchise regulation or related legislation in existence anywhere in Africa. Characteristic of emerging economies in general, survey results indicate that Africa also tends to lack a sufficient history of legal precedents and case law with regards to franchising so as to facilitate the accurate evaluation and interpretation of the practice. Without a clear understanding of franchising practices, there is a danger that the legal and regulatory environment would interpret the strategy from the context of older business models. This concern was confirmed through the interviews conducted in the target countries.

The Franchise Association of Southern Africa ("FASA") requires its franchisor members to provide prospective franchisees with mandatory pre-sale disclosure as a condition of membership. No such stipulations exist anywhere else in Africa. This disclosure process ensures prospective franchisees are provided in writing with any qualitative or quantitative fact or information that may reasonably be determined to influence that prospective franchisee's decision to join that franchise system. Without pre-sale disclosure, franchisees do not have access to the necessary information upon which to base a sound business decision. In addition, a franchisor's history of poor performance may be concealed from the prospective franchisee until it is too late.

Franchise specific legislation is therefore recommended in Africa. Franchise specific legislation provides all parties with a clear legal definition and a framework for better understanding thereby enhancing the utilisation of the model. However, given that franchising is essentially about the relationship between a franchisor and franchisees, an effective court system is instrumental to safeguarding the integrity of this relationship by interpreting the contract in a reasonable and predictable way. Franchise regulation would therefore be most beneficial if it includes a definition, a requirement for pre-sale disclosure and a stipulation that the franchisors and franchisees act in good faith towards each other in complying with the spirit and intent of the contract.

Given the extended length of time that it would predictably require to draft and enact any form of franchise regulation, franchise-financing initiatives provided by the AfDB or other public bodies may be used as an effective substitute by ensuring that any financing is strictly conditional on compliance with a series of prescribed practices (effectively, franchising "best practices"), including what would be de facto pre-sale disclosure and relationship requirements. Financing capital ostensibly intended for franchise system growth would therefore be limited only to those franchise systems with a proven track record of "best practices". Any other franchise system would be obliged to rely on conventional lending avenues. Hence, while less qualified franchise systems would not be directly penalized, AfDB franchise financing incentives would serve to encourage and reward good business practices through access to expansion capital.

Chapter 9, Potentials for the Growth of Franchising in Africa, explores the types of franchised businesses that could be particularly useful in the African context.

It was observed that most franchise systems in Africa currently serve the top one-third of the market, largely located in urban areas. Consideration was therefore given to franchise systems that could serve the needs of the rest of the population. These traditional characteristics were evaluated and challenged in that, left as is, they would represent severe challenges to the ability of franchising to benefit large segments of Africa's population. The concept of economic modelling was therefore introduced in conjunction with the management accounting concepts of cost-volume-profit relationships to franchised business in order to illustrate the point that franchising can be viable at lower sales volumes (expected in rural areas with smaller population bases) by minimising or eliminating the capital investment and operating overheads associated with traditional franchised businesses operating from retail locations.

The severe limitation of investment capital and a large rural-based population supports the view that franchised businesses requiring a minimal capital investment and minimal, if any, retail space (hence lower monthly fixed costs and the consequent breakeven point) would be more affordable by the average prospective franchisee and relatively easier to finance. Home-based or service-based franchised businesses would be the most well suited opportunities to the African environment. These businesses would generally be in the nature of personal services businesses relying more on labour than capital equipment. A number of examples were provided by way of illustration. These franchised businesses were also seen to have a potential impact on the informal sector and empowering women in the work force.

Services that satisfy basic needs, such as health care, education, and the supply of clean water, were also discussed as franchise systems that already exist elsewhere in the world and could be readily adapted to the African environment. In addition, these franchise concepts also share the characteristics of home/service-based businesses with low capital investment levels and minimal fixed operating costs.

Chapter 10, Articulating a Strategy for the Development of Franchising in Africa, summarises the findings of this report prior to presenting its recommendations with regards to developing the franchise sector in Africa. These findings include the fact that franchising contributes to the public policy initiatives of employment creation and poverty reduction while creating entrepreneurship through the transfer of technologies and knowledge. Franchising achieves these goals through the mentoring relationship maintained between franchisors and franchisees and by significantly decreasing the failure rates of franchised businesses in comparison to that of SMEs in general. Franchising is therefore a successful business format for SME development. It has also been established that a significant number of countries in Africa are either currently supporting franchising or have the potential to do so. This report therefore concludes that providing incentives to develop franchising in Africa would be a viable and worthwhile public policy initiative.

The research suggests that the AfDB's strategy for franchise development in Africa must be responsive to two primary constraints and two secondary constraints. The first and most important constraint is the general lack of familiarity amongst the private and public sectors, professional bodies and academics with the concept of franchising as a business strategy for growth and its potential for adaptation to the African environment. The second constraint, following closely in terms of priority on the first, is the lack of financing available to franchisees and franchisors as growth capital. Business risk for franchisees and lending risk to commercial lenders is exacerbated by the lack of any form of general franchise regulation. This increased risk is caused by the predictable occurrence of opportunistic business practices by unethical franchisors intent on short-term material gain rather than building long-term business relationships with franchisees. The lack of any form of franchise regulation therefore represents a third constraint to franchise development in Africa. The fourth constraint to franchising in Africa lies in the degree of disinformation that exists as to the extent of viable market opportunities throughout the continent. The impact of this disinformation is particularly poignant when one considers that many countries in Africa are comparable to, or better than, many emerging economies where franchising appears to be growing at a prolific rate.

Given the above noted constraints, this report therefore recommends that a strategy for the development of franchising in Africa should incorporate four (4) distinct initiatives. These initiatives address capacity building, financing programs, legal and regulatory considerations and international marketing and promotion. Capacity building initiatives will be developed to codify franchising principles and practices from a multi-disciplinary perspective. Hence, training and professional development programs will be designed from the perspective of business people as franchisors or suppliers to franchise systems, public accountants, lawyers, consultants and the public sector. Capacity building programs are anticipated to be financed by the AfDB primarily through grants. Financing programs will be designed and implemented by the AfDB through local commercial lending institutions. Financing programs will be designed to be profitable and self-sustaining. Instruments will include an initial grant to serve as a "loss pool" and for operational working capital purposes and loan guarantees to the local commercial banks to a maximum of 50% of the loan principle. Letters of Credit may also be extended to local commercial banks in order to increase liquidity and on-lending purposes. Lending by the AfDB directly to franchisors or franchisees is not recommended due to its lack of a retail lending distribution infrastructure and the administrative burden that would need to be incurred relative to the revenue potential. AfDB franchise financing programs would be limited only to franchise systems that met certain qualifications. These qualifications would be designed to promote and enhance the use of franchising "best practices" and to minimise credit risk. Hence, these qualifications would include, inter alia, such factors as membership in a franchise association, the maintenance and on-going use of "pre-sale disclosure" type document in its franchise granting and awarding process, a "size test" (a minimum number of franchisees or franchised businesses in operation), a "maturity test" (franchising for a certain number of years), a "net worth test" (financial capacity for growth), a "franchise viability test" (no more than a certain minimum percentage failure rate) and a "debt service test" (the ability of a franchised business to comfortably service its debt). Legal and regulatory initiatives require the AfDB to work closely with African governments to develop and disseminate a uniform, ideally pan-African form of franchise regulation. Adequate franchise regulation is anticipated to include pre-sale disclosure and "relationship" stipulations. As it is anticipated to require many years to enact any form of franchise regulation, the qualifications imposed under the franchise financing programs (including membership in any franchise association) will provide de facto regulation in the meantime. Finally, international marketing and promotion initiatives refer to the development and implementation of aggressive, pro-active tactics designed to attract specific international franchisors of strategic significance to Africa's public policy initiatives as well as to raise the overall profile of Africa's market opportunities in the international franchise community. This initiative will require close coordination of activities by the AfDB with African franchise associations, African governments and Donor countries in order to maximize the potential for bilateral trade. Short-term objectives would anticipate the majority of the activity to result in the importation of international franchise systems to Africa. Medium term ramifications would predict a proliferation of indigenous franchise systems and a strengthening pan-African pattern of franchise system expansion. Long-term results would envision the exportation of mature, well-established African-based franchise systems to other emerging and middle-income economies and eventually into the more competitive environments of the developed economies.

Funding by the AfDB has been budgeted at $US 9 million. This report recommends allocating $US 1.5 million for capacity building, legal and regulatory, and international marketing and promotional initiatives as well as to serve as an initial loss pool on the franchise financing program. The remaining $US 7.5 million will be utilized as loan guarantees and Letters of Credit to local commercial banks in support of the franchise financing initiatives.

The basis of the strategy emulates the very nature of franchising itself: first prove that the initiatives are effective, and then replicate those initiatives in each African country as appropriate. Hence, the strategy anticipates the process of developing and testing the initiatives first - thereby proving that the initiatives are effective - then repeating their implementation on a priority basis throughout the continent. The implementation of these initiatives is anticipated to occur in three (3) distinct phases spanning a timeframe of some ten (10) years.

The strategy for the development of franchising in Africa envisions the establishment of franchise business clusters utilizing the existing franchise associations as nuclei. These business clusters would form regionally based strategic platforms from which franchise activity would eventually disseminate. Multiple strategic platforms would act as redundant centres of franchise activity and technical expertise, thereby mitigating the risk of failure of the strategy through diversification, and stimulate a multiplier effect with regards to franchise growth throughout the continent. The strategy recommends that South Africa be adopted as the first strategic platform in Phase One of the strategy (anticipated to last from launch to 18 to 24 months); Egypt, Morocco and Nigeria in Phase Two (anticipated to span years 2 to 5 from launch) and Kenya by Phase Three (years 5 to 10).

1. Background to the Study

1.1 Preface

In accordance with the Agreement Establishing the Bank, the objective of the African Development Bank (the "AfDB") is to contribute to the economic development and social progress of African countries. For this purpose, the AfDB is mandated to mobilize and increase investment flows to the continent. The private sector is the main conduit for investments needed for Africa's development. In fact, about 83 % of all long-term resources flowing to developing countries are now private flows (both capital market flows and foreign direct investments). Hence, the AfDB has taken on private sector development as one of its operational priorities.

In terms of its share in the GDP (Gross Domestic Product), the private sector has overtaken the public sector in most African countries. However, the level of development of private enterprises is low. The size of the modern corporate sector is very small in most countries. Over 90% of private businesses are small and medium enterprises (SMEs), many of which are actually family firms (Aitken, 2002). The technological and managerial capacities of African enterprises are generally weak. Their participation in international competition is limited. The corporate governance practice of companies also leaves a lot to be desired.

Given these circumstances, entrepreneurial development and capacity building are the key building blocks for the growth of the private sector in Africa. Franchising as a form of business organisation is a good way to stimulate entrepreneurship and developing business capacities by linking mature and young businesses together, and connecting international and African enterprises. Franchising is a useful instrument for promoting private sector development in Africa.

Furthermore, poverty reduction is the overarching objective of the African Development Bank's operations. SMEs have proven to be an efficient means of improving the welfare of the poor through their impact on income and employment. International experience demonstrates that franchising promotes SME development. Franchised businesses, whether franchisors[1] or franchisees[2] are mainly SMEs, even in the developed countries. Because franchised outlets are part of a larger business system and the franchisor provides continuous support and coaching to the franchisees, the success rate of franchised enterprises is significantly higher than that of stand-alone businesses. Therefore, franchising development has the potential to contribute to poverty reduction, both through sustained job creation for employees of franchised businesses and wealth creation for entrepreneurs as franchisees.

Recognising the substantial benefits franchising development can bring about, the African Development Bank's Private Sector Arm has decided to investigate franchising as one of its operational themes. However, the existing knowledge of franchising activities in Africa is inadequate. Governments, private entrepreneurs and even donors are not sufficiently aware of the positive impact that franchising can have on private sector development and poverty reduction. It is within this context that the following study has been conducted.

1.2 Objectives

In accordance with the Terms of Reference, the objectives of this research study have been defined as follows[3]:

1.2.1 Investigate the present level of franchising development in Africa, including among others generating and analysing data about the number of franchise systems and franchised outlets, the importance of franchising in production and service sectors, and the significance of employment by franchised businesses in various countries.

1.2.2 Review the strengths and weaknesses of the franchising sector (systems) in Africa, including the brand value of existing systems, their capacities and potentials for expansion within or outside the originating countries, typical problems encountered during the history of development, possible managerial, technical or methodological weaknesses.

1.2.3 Demonstrate the value of franchising development for promoting entrepreneurship, technology transfer, SME development, exports and generally the growth of the private sector; in addition to poverty reduction through generating employment and providing income for the poor, with specific examples and case studies.

1.2.4 Analyse the business climate and structural factors constraining the development of franchising in Africa, such as the capacity for capitalization, external financing, accessibility of foreign exchange for making payments to international franchisors, availability of franchises, infrastructure, consumer habit, business culture, etc.

1.2.5 Find out the existing legal and regulatory framework and practice for franchising activities in Africa, highlight problems and propose options for improvements, particularly with respect to such issues as the protection of franchisor and franchisee's rights, trademark, termination of contracts, re-negotiation provisions, leasing of assets, payment of fees, etc.

1.2.6 Identify the specific characteristics of franchising activities on the continent, review the potential for developing the franchising industries in different categories of countries in light of the changing regional and global economic and political environments. Examine any special franchise systems, approaches or requirements that may be needed for franchise development in the context of Africa.

1.2.7 Look into the role that has been played by international franchises in developing the franchising industry in Africa, the desirability of attracting international systems, and the potential measures and incentives necessary for bringing in international players.

1.2.8 Review international best practices in franchising development and underscore the experiences which could be useful for Africa, to be supported by cases of countries from other parts of the world who have successfully developed a franchising industry in a way that

1 See Section 2.4.1 for definition

2 See Section 2.4.2 for definition

3 Terms of Reference Study on Franchising Opportunities in Africa, Private Sector Department, African Development Bank, pp 1-2.

benefits overall private sector development and poverty reduction.

1.2.9 Assess the respective role of the governments, the private sector and the donors in promoting the franchising industry in Africa in the past, and recommend the contributions required of them in the future.

1.2.10 Develop a strategy for the Bank to foster franchising development on the continent, including medium and long-term objectives, approaches, instruments, target beneficiaries, priority countries, sectors, partners and resource requirements, etc.

1.2.11 Seek out business opportunities and propose specific interventions by the Bank, including technical assistance and lending operations.

1.2.12 Any other areas related to the subject of the study.

1.3 Scope and Methodology

This study was based on both primary and secondary research. The primary research was conducted through a series of one-on-one interviews held with franchisors, franchisees, bankers, lawyers and management consultants with direct involvement in the franchising sector, as well as donor organisations and governments with direct or indirect interest in SME development in general. The secondary research was conducted through a review of the existing literature available from third party academic and government bodies including information available on Web sites. A complete bibliography is included with this document. The following section will discuss in detail the methodology for the primary research.

1.3.1 Target Countries

The primary research was conducted in four countries throughout the African continent, representing varying levels of franchise development and linguistic configuration (the "target countries"). These countries were:

1. South Africa:
This country represents a "high" level of franchise development with approximately four hundred individual franchise systems and a primarily Anglophone environment.

2. Egypt:
Possesses a "moderate" level of franchise development with approximately one hundred individual franchise systems and a primarily Arabic and Anglophone environment.

3. Morocco:
Has a "low" level of franchise development with approximately forty individual franchise systems with a primarily Arabic and French-speaking environment.

4. Côte d'Ivoire: Possesses a " very low" level of franchise development with an estimated twenty individual franchise systems and a primarily French-speaking environment.

1.3.2 Target Populations

Within each country, target populations for primary research were identified as those businesses or not-for-profit organisations that were directly involved in franchising in the target countries. Target populations were defined as the following:

1. Indigenous franchisees:
individuals who are currently operating a franchised business in a target country, granted to them pursuant to some form of franchise agreement.

2. Indigenous franchisors:
businesses with the head offices in a target country that are primarily in the business of granting certain rights to third parties to operate a pre-defined business in accordance with defined operating systems and methodologies and a common trademark. In addition, there must be an on-going relationship between the franchisor and the franchisee, including the provision of consulting services in return for some form of remuneration.

3. International franchisors:
businesses with head offices outside the host country that have granted the right to an indigenous master franchisee in a targeted country to in turn grant certain rights to third party indigenous franchisees, as defined above. The rights granted to the indigenous master franchisee by the off shore franchisor include the right to operate a pre-defined business in accordance with defined operating systems, methodologies and a common trademark. In addition, there is an on-going relationship between the indigenous master franchisee and the off shore franchisor, including the provision of consulting services in return for some form of remuneration.

4. Indigenous master franchisees:
businesses with the head offices in a target country that have been granted the right by a non-indigenous franchisor to in turn grant certain rights to third party indigenous franchisees for the purpose of operating a pre-defined business, in accordance with defined operating systems, methodologies and a common trademark. In addition, there must be an on-going relationship between the indigenous master franchisee and the indigenous franchisee, including the provision of consulting services in return for some form of remuneration.

5. Financial institutions:
banks or other lending institutions indigenous to the target countries that are normally involved in financing Small and Medium Enterprises ("SMEs").

6. Government bodies:
government ministries or departments indigenous to the target countries that are directly responsible for stimulating and supporting the creation and expansion of SMEs.

7. Legal firms:
law firms or lawyers in private practice that are indigenous to the target countries and specialize to varying extents in legal matters directly related to franchising.

8. Donor agencies:
agencies, ministries, organisations or institutions funded in whole or in part by various national governments that in turn provide funding to the African Development Bank.

9. Within each country,
target populations for primary research were identified as those businesses or not-for-profit organisations who were directly involved in franchising in the target countries.

1.3.3 Sources of Empirical Data

The primary research was conducted through the use of questionnaires administered during one-on-one interviews with respondents from the target populations as defined above. Examples of the questionnaires used in the interviews are included in

Appendices 1 to 6. Details about the respondents from the four target countries are found in Appendices 7 to 9.

Although conducting individual interviews through the use of questionnaires is labour intensive, it yields the most detailed information. In addition, personal interviews of this nature often generate relevant and highly insightful anecdotal evidence that is often missed or overlooked in a static questionnaire document. Audio tape recorders were utilised where permissible by the interviewee, in order to capture and subsequently document such relevant anecdotal data that may otherwise be unobtainable through a static questionnaire.

The actual sample sizes per target population are summarised in Table 1-1 below.

Table 1–1: Target Populations

Target Populations	South Africa	Egypt	Morocco	Côte d'Ivoire	Total
Franchise Systems	45	23	7	3	78
Financial Institutions	2	1	7	1	11
Legal Firms	8	7	2	0	17
Consultants and Government Agencies	3	5	2	5	15
Total	58	36	18	9	121

Further interviews were conducted with North American financial institutions, international franchisors, franchise associations and franchise consultants outside of Africa. These are summarised in Table 1.2 below.

Table 1–2: Summary of Financial Institutions, International Franchisors and Consultants Interviewed

Interviewees	Number of Interviews
Financial Institutions	4
International Franchisors	5
Franchise association	1
Franchise Consultants	4
Total	14

1.4. Organisation of the Book

This book organises the research in 10 chapters. A brief summary of the contents of those chapters is as follows:

Chapter	Chapter Overview
Chapter 1: BACKGROUND TO THE STUDY	Defines the terms of reference and objectives of the research study.
Chapter 2: FRANCHISING	Provides a working definition of franchising as first and foremost a business strategy entered into by a number of independent SMEs. It then introduces certain principles, methodologies and techniques that have developed into franchising "best practices" during the course of its evolution.
Chapter 3: STATUS OF FRANCHISING INTERNATIONALLY	The objective of this section is to place the body of research presented in this work within the context of the historical evolution and global implementation of franchising. This analysis attempts to identify certain patterns of development experienced in other countries, including emerging economies that may prove useful in Africa.
Chapter 4: ENVIRONMENTAL AND STRUCTURAL ISSUES AFFECTING FRANCHISING IN AFRICA	The objective of this chapter is to examine the general environmental conditions, including the business climate and structural factors that may have influenced the extent of franchise development throughout the African continent and particularly in the countries surveyed. As a corollary to this chapter, we intend to juxtapose the environmental conditions observed in the international franchise community to that of the African environment, in order to assist us in developing a strategy for franchise development for this continent. It is a presupposition of this report that certain factors must be in place in a given environment in order to attract foreign investment and stimulate economic growth. This section therefore describes and examines the factors that have been identified as obstacles to engaging in business in any particular country.

Chapter	Chapter Overview
Chapter 5: ANALYSIS OF THE FRANCHISE SECTOR IN AFRICA	This chapter explores the nature and extent of franchising in Africa. This discussion analyses the results of the primary research conducted in the target countries with regards to the brand value of existing systems, capacities or potentials for expansion within or outside of their countries of origin, typical problems encountered during their development as well as an analysis of the current managerial, technical and methodological strengths and weaknesses of the franchising sector in Africa.
Chapter 6: THE ROLE OF INTERNATIONAL FRANCHISING IN AFRICA	This chapter evaluates the role that has been played by international franchises in developing the franchise sector in Africa, ascertains the relative desirability of attracting international franchisors to expand to Africa, and the potential measures and incentives necessary to attract those international franchisors.
Chapter 7: THE CONTRIBUTION OF FRANCHISING TO ECONOMIC DEVELOPMENT IN AFRICA	Provides an economic perspective to the contribution that franchising has made in Africa. This chapter briefly reviews the driving forces of economic development and then explains the method of analysis in conjunction with the data sources. Next, a model of franchising is proposed, which emphasises the main interactions between the agents in terms of flows of user rights, information and rewards. The fourth section of the chapter analyses the specific contributions of franchising to the formation of entrepreneurship, technology and knowledge transfer, the strengthening of the small and medium enterprise sector, employment creation, foreign exchange earnings and poverty alleviation.
Chapter 8: LEGAL AND REGULATORY FRAMEWORK	This chapter evaluates the existing legal, regulatory and judicial framework and practices in the context of promoting or inhibiting franchising activities in the Target Countries. It then highlights problem areas with a view to proposing options for improvements.
Chapter 9: POTENTIAL FOR THE GROWTH OF FRANCHISING IN AFRICA	This chapter examines the types of franchise concepts that may be best suited to the African environment as well as summarising the approaches and requirements identified throughout the study in terms of what will be needed to stimulate the growth of franchising throughout the continent.
Chapter 10 ARTICULATING A STRATEGY FOR FRANCHISE DEVELOPMENT IN AFRICA	This chapter summarises the results of the study and identifies and discusses certain conditions of a strategy to develop franchising in Africa including target beneficiaries, the likely impact by industry or sector, which African nations might be considered priority countries as well as the instruments that would most likely be the most effective. In addition, this chapter identifies certain potential strategic partners that can assist in the development and implementation of the strategy as well as its basic approach. A strategy for the development of franchising in Africa is then presented in terms of short, medium and long-term stages or phase-in periods.

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