The future of micro-franchising

Micro-franchising is an acclaimed approach in BOP business models. However, new micro-franchise concepts struggle to achieve profitability. What are the factors that seem to hinder development of profitable micro-franchise concepts and how can your company avoid these pitfalls?

**Micro-franchising** employs the same core principles as traditional franchising known from high-income markets. The idea behind micro-franchising is to create a scalable business opportunity, which can be owned and operated by people living at the BOP. Micro-franchising has been seen as a powerful economic accelerator in the developing world. In 2008 the report “Micro-franchising at the Base of the Pyramid” by the Acumen Fund stated that “The initial signs of benefits of micro-franchising are highly encouraging”. High profiled cases as CFW Shops and VisionSpring have utilized micro-franchising to address health issues. These examples of “social micro-franchising” have developed confidence in micro-franchising as a driver of social and economic change for people living at the BOP.

However, recent research on micro-franchise concepts developed during the last decade reveal that there are a range of challenges, which hinder development of financially sustainable micro-franchise concepts. The following will highlight the factors that challenge the financial sustainability of micro-franchise and especially social micro-franchise concepts. Understanding how these factors affect profitability is essential for developing micro-franchise concepts, which include social benefits without compromising financial sustainability.

**The challenges for social micro-franchising**

Developing a profitable business model is difficult in any market, but the nature of low-income markets implies that the margin for error is particularly slim.

Practitioners estimate that currently 80-90% of social micro-franchises are unprofitable. The consequence of unprofitable social micro-franchises is that they struggle to scale-up successfully and effectively serve their customers. While social micro-franchises as CFW Health Stores possibly serve the health needs more cost effectively than public and other grant funded health services, continued grant support to unprofitable micro-franchises might hinder development of truly sustainable business models.

**Social objectives vs. profitability**

The challenge for social micro-franchises as CFW Health Stores and VisionSpring is an apparently inherent conflict between the social mission and profitability. Business models are challenged when social objectives prioritize inclusion rather than exclusion of those with the highest needs, but the lowest ability to pay.

The report “Franchising in Frontier Markets” has highlighted how social objectives tend to affect three aspects critical for a profitable and consequently sustainable micro-franchise concept, namely outlet location, product mix and client selection.

In high-income markets location of outlets is a key decision for unit profitability. The same is the
case in low-income markets. Unfortunately, locations where the social need is most pressing also tend to correlated with locations where it is the most challenging to create high revenue and profitability.

Additionally the product mix is currently often reflecting what donors believe is important, as clinical services for sexual reproductive health, which is not necessarily seen as a first priority by consumers.

Finally, the client selection of micro-franchises with a social mission aims to include rather than exclude. Reaching poor rural areas involves high distribution cost, which combined with a low purchasing power limits revenues.

**What characterise profitable micro-franchise concepts**

FanMilk developed a business model based on a micro-franchising concept, before the concept of micro-franchising and BOP existed. After 50 years of operation in West Africa it is interesting to compare how FanMilk and the social micro-franchise concept CFW shops tackle critical factors.

- **Site selection**: FanMilk’s distribution and sales is focused on urban centers and mostly in urban areas where the population density is high. Due to the low purchasing power in low-income markets, business models’ targeting the BOP creates profitability through number of units sold rather than a high per unit margin (absolute value). CFW shops are located throughout Kenya including rural settings. A rural village with low population density and high distribution cost makes it challenging to achieve profitability due to a lower concentration of potential customers and higher cost on an already slim profit margin.

- **Financial requirements and franchisee selection**: The is no initial capital requirement for a franchisee (street vendor) in the FanMilk concept. A bike or other appropriate vending tool and the daily inventory is provided on credit basis for the day, i.e. a kind of interest free micro credit on very short term. Comparably CFW shops require a $300 up front payment and a $1,200 loan from the franchisee and additionally CFW covers an approximately $2,000 refurbishing of the clinic. The fact that no initial capital investment to FanMilk is required compared to CFW implies that it is easier for FanMilk to find franchisers and select those with most entrepreneurial drive, thus creating a more dynamic franchise selection.

- **Efficiency and overhead cost**: Several social franchise concepts have a significant overhead burden, steaming from international headquarters, marketing and distribution costs. For example, in 2007 VisionSpring’s headquarter cost totalled 367% of company revenues. Franchise concepts from high-income markets predominantly increase profitability through scale.

- **Profitability vs. scaling**: Recent research has not found a social micro-franchise concept, which started on non-commercial terms with grant funding and then moved to a fully profitable business model. Creating a profitable business model before scaling seems to be essential.