African Development Bank

Study on Franchising Opportunities in Africa

Background Paper
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the Franchise Africa Symposium.

The views and interpretations in this paper are those of the author and not necessarily those of the African Development Bank

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1. INTRODUCTION AND OVERVIEW

1.1. Preface

This Background Paper is prepared for distribution at the Franchise Africa Symposium to be held in Johannesburg, South Africa on May 6 and 7, 2002. The paper is based on preliminary research contained in a more detailed work under the same name commissioned by the African Development Bank.

Franchising has been increasing in prominence of late due to its acknowledged dominance of the consumer goods and services sector in North America, the increased awareness of the importance that Small and Medium Sized Enterprises ("SMEs") have on economic growth, and the significant impact Franchising has on the degree of success of SMEs who are Franchisees. Franchising is therefore valued for its positive impact on the Private Sector growth, especially SMEs.

1.2. Objectives

This Background Paper attempts to facilitate discussion and debate amongst Symposium delegates as to the potential contribution of Franchising to economic development, particular those that may pertain to African countries. As a corollary to that discussion, we will present a brief exploration of the roles and potential strategies that international Donor organizations, governments and the private sector may adopt to optimize the beneficial effects of Franchising throughout Africa. Finally, we will identify issues for further investigation.

1.3. Approach and Methodology

The Background Paper introduces the research through five sections:

The first section provides a working definition of Franchising as first and foremost a business strategy entered into by a collection of independent entrepreneurs. It then introduces certain principles and practices of Franchising that have been developed by those entrepreneurs during the course of Franchising's evolution.

The second section of the paper explores the nature and extent of Franchising in the African context. This discussion explores the environmental factors that affect Franchising as well as an analysis of the current strengths and weakness of the Franchising Sector in Africa. Finally, this section will suggest certain types of franchise systems that may be particularly well suited to the African context.

The third section of the paper provides an economic perspective to the contribution that Franchising has made in Africa.

The fourth section evaluates the impact of the legal and judiciary environment on Franchising in Africa.

In conclusion, the fifth section presents a discussion of the potential roles and strategies that international Donor organizations, governments and the private sector may adopt to optimize the beneficial effects of Franchising throughout Africa.

1.4. Basis of the Discussion

The discussion is 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, Solicitors and Management Consultants with direct involvement in the Franchising sector, as well as Donor organizations 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, including information available on Web-sites.

2. THE PRINCIPLES AND PRACTICES OF FRANCHISING

2.1. Overview

"Franchising" is a Business Strategy

The existing literature tends to associate the term "Franchising" with the qualifier "American". Hence the oft used phrase "American Franchising". This bias is understandable given the generally accepted belief that both Trade Name Franchising and Business Format Franchising began in the United States with Singer Sewing Machine in the 1850's and Ray Kroc of McDonalds in the 1950's respectively.

Therefore it is necessary to understand that Franchising is first and foremost a "business strategy", *regardless* of country of origin. It is generally understood that all entrepreneurs everywhere wish to maximize opportunity and minimize financial risk. Franchising is simply another way of doing this.

It is also important to keep in mind that Franchising is, by its nature and origins, a business strategy designed by SMEs for SMEs. Regardless of whether those SMEs are *Franchisors* or *Franchisees*.

The Principles and Practices of Franchising

A growing body of research attempts to measure the *effects* of Franchising (economically or otherwise) but little if any research is done in the area of "how" is Franchising implemented and "why" is it done that way.

"Best practices" in Franchising are most often anecdotal and experience based. They are in fact a form of "knowledge", which can be acquired. This knowledge or expertise is usually only shared or understood by and between seasoned franchise practitioners who have been involved in one or more Franchise Systems over the course of years.

This leads to the objective of identifying and discussing Franchising "best practices" and principles so that one can establish a common understanding of terms, principles, practices and causal relationships as a framework of analysis. Therefore Section 2 presents such suggested working definitions.

2.2. Definition

"Franchising" is generally described as the granting or licensing of certain defined intellectual property rights and access to certain tangible and intangible benefits and privileges by one SME (the "Franchisor") to another (the "Franchisee"). We refer to Franchisors as SMEs because, while some may eventually evolve to large, multinational status (such as McDonalds Corp.), the majority of Franchisors never attain such development.

Characteristics of Franchising are identified (Paswan, Dant 1994) as follows:

1. "A privilege granted or sold or right given by a Franchisor to Franchisees.
2. The privilege could be the usage of the Franchisor's product, name, and methods and procedures for doing business.
3. The Franchisor provides the Franchisees with the product, trademark/name, and assists through organizing, training, merchandising, advertising, promotion, management, and other business related advises and activities. The Franchisor may even have a significant degree of authority and control over Franchisee operations.
4. Franchisees, in turn, adhere to the business/marketing plans laid out by the Franchisor. There may also be some sort of fees associated with it, although not essential.
5. The terms and conditions or considerations are mutually agreed upon."

2.3. Types of Franchises

Franchise relationships are generally subdivided into three (3) types:

Trade Name Franchises

Trade Name Franchise rights and privileges are generally limited to the non-exclusive use of the Franchisor's Trade Marks and access to the Franchisor's products and services on a wholesale basis. It is the oldest form of Franchising (Singer Sewing Machine) and is still practised in such areas as soft drink bottling and distribution as well as automotive dealerships. Trade Name Franchises inherently assume that all entrepreneurs possess more or less equal business skills, attributes and resources. Hence, access to a well-known product and associated Trade Name is all that is needed to provide an SME enterprise with a decisive competitive advantage over other independent SMEs.

Distribution

Distribution Franchising may be generally described as an affiliation of SMEs into a form of buying group. In this case, independent SMEs in the same industry attempt to compete against large chain store operators and often, Business Format Franchise Systems, by agreeing to share a common Trade Name and increasing their margins by combining their individual product purchase volume. Examples of this form of Franchising can often be found in grocery and convenience stores, as well as pharmacies.

Business Format

Business Format Franchising rights and privileges, as with Trade Name Franchises, also include the non-exclusive use of the Franchisor's Trade Marks and access to the Franchisor's products and services on a wholesale basis. However in addition, the Franchisee also has access to the benefits of a defined method of doing business (the "Operating System") that has been historically proven by the Franchisor to be effective, *as well as* on-going management information, consulting and advice from the Franchisor relating to the franchised business ("On-going Support").

The Business Format Franchise was reputably first formatted by Ray Kroc of McDonalds. In evaluating the potential acquisition of the McDonalds Franchise System from its founders, Kroc discovered that McDonalds numerous Franchised Restaurants of the time were experiencing widely fluctuating operating and financial results. Further investigation led Kroc to the conclusion that all entrepreneurs are *not* in fact created equal. McDonalds Franchisees reflected a melting pot of different backgrounds, skills, strengths and weaknesses as well as financial resources. It was apparent from the results that the McDonalds product value proposition and associated Trade Name were not in themselves sufficient to provide reasonable assurance of an SME Franchisee's success. Hence, in order for his investment to be successful, Kroc believed that he had to increase the level and consistency of success throughout the Franchise System. He accomplished this by interviewing McDonalds founders and McDonalds most successful Franchisees, documenting those operational and managerial "best practices" in the form of exhaustive Operations Manuals, and ensuring that everyone in the Franchise System (Franchisor management and Franchisees alike) successfully completed an in-depth Training Program.

It is therefore the combination of a common and distinct Trade Name with the codification of a proven and exhaustive methodology of business and a series of preventive and detective management controls that has proven to be the most successful form of SME development yielding the highest economic utility.

This research will therefore consistently refer to "franchises", "Franchising" and any variation thereof as referring to "Business Format Franchising" specifically.

2.4. Levels of Franchising (Agents)

Franchising has various levels or variations of function. These functions may be described as:

Franchisors

Generally described as the entrepreneurial person or entity that has developed or otherwise owns and controls defined intellectual property rights and can provide access to other tangible and intangible benefits and privileges to another (the "Franchisee").

For the purposes of this analysis, we are categorizing Franchisors into two (2) subsets: "International Franchisors" and "Indigenous Franchisors".

International Franchisors

International Franchisors are Franchisors that have expanded their Franchise Systems outside of their country of origin. There are four (4) commonly accepted methods of franchise expansion internationally. These are:

Direct Franchising

Where a Franchisor with its Head Office in one country (a "Foreign Franchisor") grants franchise rights and consequently provides on-going training and support directly to Franchisees ("Indigenous Franchisees") residing in a different country (the "Host Country").

Wholly–Owned Subsidiary

Where a Foreign Franchisor establishes a wholly owned corporate subsidiary in the Host Country for the purpose of granting franchise rights directly to Indigenous Franchisees and consequently providing on-going training and support to those Franchisees.

Joint Venture Agreements

Where a Foreign Franchisor enters into a Joint Venture agreement with an indigenous government, business entity or entrepreneur for the purpose of establishing and developing the Foreign Franchisor's Franchise System. The respective parties' contribution may differ widely from one case to another.
Contributions would include such resources as intellectual property (including Trademarks, Processes, Methodologies and "Know-How"), property, plant and facilities, working capital, human resources, etc.

Master Franchising (also known as "Sub-Franchising")

Where a Foreign Franchisor grants rights to an indigenous business entity or entrepreneur (the "Master Franchisee") to, in turn, grant franchise rights directly to Indigenous Franchisees and consequently providing on-going training and support to those Indigenous Franchisees. In effect, the Franchisor has "sub-contracted" its rights and responsibilities to an indigenous third party. Master Franchisees are often, although not always, indigenous to the Host Country.

Indigenous Franchisors

Where a Franchisor with its Head Office in the Host Country grants franchise rights directly to Indigenous Franchisees and consequently provides on-going training and support to those Indigenous Franchisees.

Franchisees

Generally described as the entrepreneur to which the right to use (and thereby benefit from) certain defined intellectual property rights and access to certain tangible and intangible benefits and privileges is granted by a Franchisor.

A "Franchised business" is defined as a business that is established and operated by a Franchisee in accordance with parameters previously defined by the Franchisor.

Single Unit Franchising
The entrepreneur to which the right to establish and operate one (1) Franchised business is granted.

Multi-Unit Franchising
The entrepreneur to which the right to establish and operate two (2) or more Franchised businesses is granted.

Area Developers
The entrepreneur to which the right to establish and operate two (2) or more Franchised businesses is granted within a defined geographic area.

2.5. The Business Life Cycle of Franchise Systems

A Franchise System, like any form of business, grows and evolves through distinct stages. Each stage has its own characteristics, challenges and complexities, which it must deal with in order to survive and continue to grow. In the Franchising context, these stages of growth also have an impact on the implementation of best practices and credit risk assessment. If we are to explore potential financing vehicles to stimulate rapid franchise growth, it is important for us to understand these concepts.

Emerging Franchise Systems

Emerging Franchise Systems are generally described as either entrepreneurs, who are just beginning the process of implementing a Franchise System, or Franchisors with less than 20 Franchisees and less than 5 years experience in Franchising. Characteristics generally include a close, almost familiar relationship between the Franchisor Founder and the original group of Franchisees, minimal Home Office support staff, few if any middle to senior management positions other than the Founder. To the Founder, Franchising is a new concept and represents a "paradigm shift" from thinking of himself as a "retailer" providing goods and services to consumers to thinking of himself as a "Management Consultant" who teaches others how to be a retailer. The Founder is very "hands on" in Franchisee selection, training and support. The Founder quickly discovers that Franchisees are not employees and cannot be treated like employees. He also discovers that Franchising is a lot more complicated than his lawyer lead him to believe. Systems are often ad hoc, franchise-marketing budgets are moderate due to cash constraints and the average cost per franchise granted is high as Brand Equity and Brand Recognition is low. Successful franchise expansion is therefore critical to ensure Franchise Fees received can be re-invested into franchise expansion efforts. Successful franchise expansion efforts focus on cluster development in Primary Markets first.

Mezzanine Level Franchise Systems

The Mezzanine level of growth is described as a Franchise System between 20 and 60 Franchisees and 5 to 10 years of Franchising. Mezzanine level Franchisors are beginning to bring in professional managers and learning to delegate. The Founder is therefore still very much involved on a day-to-day basis but may or may not sit in on every management meeting for every department. Many Founders find this stage particularly difficult due to the delegation of authority to professional management. Characteristics generally include a gradual distancing from the original group of Franchisees, minimal interaction with the new generation Franchisees, and a growing number of middle to senior management positions including the Founder. The Founder is now beginning to recognize patterns in Franchisee behaviour and is developing a level of comfort with the Franchisor and Franchisee respective roles. The Founder is less involved in Franchisee selection, training and support and is becoming more strategic in his approach including a focus on Franchise System performance and marketing and sales. Systems have been generally developed, franchise-marketing budgets are high and the average cost per franchise granted is dropping. This is due to the fact that Brand Equity and Brand Recognition have begun to rise, customers and investors recognize the Brand and inquire about the opportunity without seeing a newspaper advertisement. Successful franchise expansion continues to be critical to ensure that Franchise Fees received can be re-invested into franchise expansion efforts. Successful franchise expansion efforts now focus on cluster development in Secondary Markets while Primary Markets complete their expansion through their previously developed momentum.

Mature Franchise Systems

The Mature Franchise System level of growth is described as a Franchise System 60 or more Franchisees and 10 years or more in Franchising. Mature level Franchisors are now run by professional managers. The Founder is less involved on a day-to-day basis and rarely sits in on management meetings. Characteristics generally include minimal interaction with the existing or new generation Franchisees. The Founder is less involved in Franchisee selection, training and support and is becoming more strategic in his approach including a focus on Franchise System performance and marketing and sales. Systems are developed, franchise-marketing budgets are low and the average cost per franchise granted is the lowest it's ever been due to long run average cost curves. This is due to the fact that Brand Equity and Brand Recognition are high; customer and investors recognize the Brand and inquire about the opportunity without seeing a newspaper advertisement. Successful franchise expansion continues to be critical to ensure Franchise Fees received can be re-invested into franchise expansion efforts. Successful franchise expansion efforts now focus on cluster development in Tertiary Markets while Secondary Markets complete their expansion through their previously developed momentum.

The risk of business failure is therefore highest with the Emerging Franchisor and declines as the Franchise System matures. The credit risk associated with Emerging Franchisors can be mitigated through technical and managerial development, membership in trade associations, etc.

2.6. The Philosophical Context of Franchising

Preconditions to Franchising:

The notion of franchise feasibility presupposes two basic assumptions:

a) That the "prototype" business (the original business upon which the Franchise Concept is based) has a sustained, historical record of positive cash flows resulting in an attractive return on invested capital. To satisfy this condition, it is logical to assume that the Prototype must be mature in order to establish a track record of positive cash flows. We would therefore assume the Prototype must be at least three years old. It is important to note that it is not necessary at this stage to have documented systems and procedures. The historical performance provides reasonable assurance that the intellectual property or "Know How" exists, even if it is not yet documented. We refer to this as the "Going Concern Assumption".

b) That the Prototype can be successfully replicated, including any tangible and intangible assets, "Know How", systems, practices and techniques, so that an individual other than the creator of the Prototype can operate the business as successfully as the creator. We refer to this concept as the "Principal of Replicatability".

Strategic Partner Paradigm

Franchising is a business strategy implemented by Franchisors. Franchisees are the Franchisors de facto partners in implementing and executing that strategy. We may therefore postulate that Franchisees are the Franchisors' "Strategic Partners" (separate and distinct from being "legal" partners). It therefore also leads to the conclusion that Franchisor/Franchisee relationship is not one of "Master/Servant" (i.e. Employer/Employee). Hence, the role of the Franchisor is often described as the "steward" or "custodian" of the Franchise Operating System and Marks, and a "consultant" or "advisor" to its Franchisees in their use and implementation.

The role of the Franchisee is to adapt (if and only if practically necessary) and implement the Operating System to the market idiosyncrasies within which the Franchisee does business. This introduces the notion of "***Labour Specialization***" in that in order for the Franchise System to operate at its optimum, each participant has a specific role to play and responsibilities to perform. The concept of "***Learning by Doing***" (Arrow) suggests Franchisees can master the techniques of the Franchisors' Systems and Know How through, in effect, on the job training. Therefore the "tools" of the Franchisor, as with any consultant, are described as "influence, persuasion and recommendation". A researcher once documented the notion that if compliance ever needs to be enforced contractually, then the franchise relationship is by that time usually too damaged to be effective anymore (Bradach, 1998).

Political Philosophy Paradigm

Franchising may be described as "Collective Thought" rather than "Individual Thought". Franchising assumes that what is right or correct for the whole Franchise System is by extension right or correct for the collected individuals within that System. This is juxtaposed to Individual Thought, which assumes that what is right for the individual, is by extension, right for the collected individuals in that System.

Economic Democracy Paradigm

This "Collectivist" perspective suggests that individuals contemplating an investment in given Franchise System must be comfortable with the notion that their opinion is only one of many. Complimentary descriptive phrases would include "Consensus", "Team", "Cooperation", "Compromise", and "Win-Win Solutions". This collectivist perspective leads to the concept of "Economic Democracy"; whereby Franchisors and Franchisees exercise degrees of influence with regards to decisions that may affect the economic model of the Franchised business.

Franchisee Profile or "Fit"

A proper "Franchisee Profile" is often described as an "Intrapreneur Profile" rather than an "Entrepreneur Profile".

An "Entrepreneur Profile" may be described as an individual who prefers a business environment wherein they can make decisions at their sole discretion, and would rather develop business system or practices, products and services as they best perceive them, without the need for reference to proven precedents. This person can operate comfortably in highly volatile, unstructured environments and in an above normal degree of stress. Entrepreneurs are often found to be too individualistic in the sense that they would tend to perceive consensus building, teamwork and cooperation as too confining, slow and inefficient.

An "Employee Profile" is an individual who is most comfortable in a highly directed, structured environment. This type of profile may feel uncomfortable with the responsibility and accountability of managing and directing the Franchised business' staff, allocating and directing the Franchised business' resources, and otherwise implementing or adapting the Operating System locally. They require a higher degree of training and support from the Franchisee, which in turn becomes a drain on the Franchisor's resources.

An "Intrapreneur Profile" is an individual who is most comfortable in a situation where they may exercise judgement and decision making ability within the context of overall working parameters (or a defined "Operation System").

System Innovation and Adaptation: The "Delta Factor"

One of the paradoxes of Franchising is the co-existence of standardization and innovation. One of the inherent strengths of the strategy is the consistent implementation of a standard set of systems and methodologies. The standardization and compliance of which are codified through the use of such "static" instruments as Franchise Agreements and Operations manuals. Yet, the "Vested Interest Dynamic" and the "Intrapreneurial" Profile of Franchisees creates a dynamic encouraging innovation and adaptation to specific market idiosyncrasies. The "Delta Factor" is a term coined to refer to a Franchise System's attempts at constantly adapting to ever changing market demands and competitive forces. Franchise Systems have therefore developed a series of mechanisms to capture, test and implement on a System-wide basis Franchisee innovations and improvements, notwithstanding an agreement, policy or procedure that may have been perfectly valid at a given point in time. These mechanisms may include Franchise Advisory Councils, Regional Meetings, Subject Specific Franchisor/Franchisee Committees and Beta (or Test) Sites for innovations.

2.7. Franchise Expansion Strategies

Best practices in franchise expansion introduce the concept of "Cluster" Strategies. Clustering refers to the targeting of certain markets for the purposes of attracting new Franchisees and establishing a given number of Franchised businesses within that market. By clustering a given number of Franchised businesses within a given market right away, Franchise Systems maximize the economies of scale that may be attained by Franchisees sharing that market in advertising and promotional programs. Conversely, Franchisors minimize the cost rendering Franchise Support costs by being able to visit more than one Franchisee in close proximity.

The reverse strategy, sometimes referred to as the "Shotgun" approach, increases the risk of creating Franchisee "Orphans". Orphans are described as Franchisees that the Franchisor has neither the time nor the resources to visit and support on a regular basis. The risk of creating Orphans is especially high with Emerging Franchisors expanding beyond their immediate market or countries of particularly large landmass or in International Franchise scenarios.

2.8 Legal Environment and Context

Given the role of Franchisors to develop, enhance and protect the Franchise System on behalf of all participants of the System; and given that Franchisees have contractual relationships only with the Franchisor rather than with each other; and given that one weak Franchisee Operator can materially affect the Brand Equity of the Franchise System in a given market to the detriment of all other Franchisees in that market; then, only the Franchisor has the ability to enforce compliance and conformity with regards to the use and implementation of Trademarks and the Operating System amongst all Franchisees. Therefore Franchise Agreements must be "Contracts Of Adhesion" so that Franchisor's have the contractual ability to enhance and protect the Franchise System on behalf of all participants.

2.9 Business Principles in Franchising

It is important to remind ourselves that any “Business” is “an adventure in the nature of trade” (Canadian Income Tax Act). This includes Franchise Systems. Understanding the basic motivations and objectives of the respective parties (Franchisors and Franchisees) provides a context within which we may understand “best practices” in Franchising.

Business Objective

We postulate that the fundamental goal of entrepreneurs is to create wealth for themselves.
We further suppose that this is equally true of Franchisors as entrepreneurs and Franchisees as entrepreneurs. The basic business paradigm therefore suggests that entrepreneurs create wealth through business with an implicit or explicit understanding of three (3) principles:

Maximize Market Share

Maximizing market share is achieved by attracting and retaining an increasing number of customers, who buy an increasing number of our goods and services, more frequently. (Drucker, 1973) This is based on the assumption that the decision to purchase goods and services is a “zero-sum game” (consumers more often buy X or Y, not both). Franchisors maximize market share by granting, establishing and supporting as many Franchised businesses in as many markets as can be reasonably viable. The ability to dominate markets through the establishment of homogenous business units introduces the Principle of “Replicatability”. The consistent replication of business units is a fundamental premise in a Franchising strategy.

Franchisees maximize market share by establishing the Franchised business, promoting the Franchisor’s Trademarks, by consistently applying the Franchisor’s Operating System and by implementing the Franchisor’s on-going operational recommendations on a timely basis.

Cost Control as a Management Objective

Expenses have certain behavioural characteristics or causal relationships with regards to sales volumes (variable expenses versus fixed expenses) that can be generally predicted. This is a basic assumption in Management Accounting Theory. These causal relationships are relatively constant within a defined range of sales volumes, known as a “Relevant Range”.

Profitability as a Derivative Outcome

Therefore, if we can attract an increasing number of customers to buy an increasing number of goods and services, more often; and the costs associated with selling those products and services remain constant relative to sales, then the profitability of that business will, ceteris paribus, increase. Therefore profits are a derivative outcome of sales minus expenses.

Minimize Risk

All entrepreneurs desire to minimize the risk of business and financial failure.
Franchisors attempt to minimize the risk of financial failure by leveraging the capital commitment needed to otherwise open retail units itself by using a Franchisee's capital and management resources. Franchisees enter into this business arrangement in return for the profits of the Franchised business.

The "Vested Interest Dynamic"

Refers to the phenomenon whereby Franchisee owned and operated businesses have been consistently observed to out perform corporate run units by a significant margin (Bradach, 1998). This performance was measured in terms of increased sales and profitability. The theory postulated is that Franchisees have usually invested a significant amount of their lifesavings in a given Franchised business. The personal investment of capital therefore creates a "Vested Interest" on the part of the Franchisee to maximize the operational and financial performance of the Franchised business. This Vested Interest generally results in a level of motivation rarely seen in hired employees with no financial commitment (the "Dynamic").

Behavioural characteristics of the Vested Interest Dynamic generally include increased working hours committed to the business by the Franchisee (resulting in lower third party wage costs), heightened customer service (resulting in higher sales per transaction, increase in customer flows by word of mouth reputation, increased repeat business) and tighter cost controls (purchasing, shrinkage, etceteras).
Therefore Franchise Agreements almost always contain "Full Time and Attention Clauses" requiring Franchisees to work in a Franchised business to the exclusion of any other business venture so as to capture this principal in the essence of the contract.

Conclusions

Franchising is a "Business strategy" designed to maximize market share and minimize risk for both Franchisors *and* Franchisees.
Franchisors and Franchisees are de facto "Strategic Partners", acting in a symbiotic relationship, with specific roles and responsibilities to play and obligations to each other.
Franchisors have a responsibility to protect and enhance the Franchise System's Trademarks and Operating System and, in addition, license, train

and support Franchisees in the proper and consistent use of those Trademarks and Operating System.

Franchisees have a responsibility to use those Trademarks and implement those Operating Systems in a reasonable diligent fashion on a consistent basis. Where adaptation may be reasonably required under the circumstances, the Franchisee and Franchisor shall act reasonably and in good faith to determine the nature
and extent of such adaptation.

It is the responsibility of Franchisors to develop, implement and manage meaningful management information systems that measure the effectiveness of the Franchise System's Operating Systems and Franchised business' operational and financial results.

It is the responsibility of Franchisees to implement and maintain such management information systems as determined by the Franchisor in order to facilitate the Franchisor's ability to collect the necessary operational and financial data for Franchise System Benchmarking purposes.

A clear understanding of Franchising "Best Practices" can foster a common understanding of the nature and dynamic of Franchising; facilitate further analysis and measurement; support the development and implementation of Professional Development programs targeted at various target groups; and support the creation of financial and other incentives to maximize the use of "Best Practices" amongst Franchise Systems.

3. ANALYSIS OF THE FRANCHISE SECTOR IN AFRICA

3.1. Overview

There are three objectives to the analysis in this section. First, we wish to examine the general environmental conditions that may have influenced the extent of franchise development in the countries surveyed. Second, we will attempt to evaluate the relative strengths and weaknesses of Franchise Systems in comparison to generally accepted "Best Practices" in Franchising. And third, we will propose certain types of franchised businesses that may be particularly suitable for the African context.

This analysis is based on questionnaires and interviews conducted with Franchisors, Franchisees, bankers, public accountants and management consultants in South Africa, Egypt, and Morocco. The Franchise Systems included in the sample were selected from the food service sector (fast food and full service formats) as well as retail, automotive and other services. Where possible, the test samples for each country included Mature, Mezzanine and Emerging Franchise Systems.

As noted in other areas of this study, the number of responses varies by question as not all firms answered every question.

3.2. Environmental And Structural Issues Affecting Franchising In Africa

Synopsis

South Africa

South Africa, with a population of 44.1 million, of which 56% represent the Urban Population, was the second largest market of the survey nations in terms of population. With a per capita income of $3,225 (1998), South Africa is the wealthiest of African countries and the largest middle-class market among the survey nations and in Africa. However, it is estimated in 1997 that 24% of the population lives on less than US$1 per day. The incidence of poverty is highest amongst blacks, women and rural populations. Infant mortality is estimated at 62 per 1,000 and the under-5 year mortality is 87 per 1000 live births. Adult illiteracy is estimated at 16% (1997).

It is also the largest Franchising nation in Africa by far, with over 23,000 franchise units and approximately 478 systems in operation, including Trade

Name Systems. About 82% of these, according to the Franchise Factor Study of 1999/2000, are domestic in origin, with the remainder originating in order of priority from the US, Australia, Canada and Europe. Franchising continues to grow in South Africa during the last few years at an estimated rate of 17% per year during the nineties, while its overall economy grew in more normal ranges between 1-3%. This growth has been sustained over much of the decade and partly explains the institutional support that has grown around the industry.

Egypt

Egypt has the largest population of the survey nations at 69 million of which 45.3% represented the Urban Population. With a per capita G.N.P. at $1,250 (1998), it has graduated to becoming a middle-income developing country. However, it is estimated in 1997 that 3.1% of the population lives on less than $1 US per day. Infant mortality is estimated at 44.2 per 1,000 and the under-5 year mortality is 52 per 1000 live births. Adult illiteracy is estimated at 44.5% (1998).

In Franchising, it is second only to South Africa with approximately 100 Franchise Systems. There is no information available on the number of Franchised businesses that exist, nor on the amount of employment the Franchise Sector generates. American Franchise Systems representing approximately 34 Fast-food brands have taken root and have quadrupled in the last five years. But the barriers to Franchising are still significant due to laws and institutions that carry vestiges of Egypt's central planning past. Still, the last decade has witnessed very significant market-oriented changes. Egypt has carried out large-scale privatizations, and dedicated itself to making the structural adjustments necessary to stabilize its macro economy. The results are impressive. The current rate of inflation is 2.5% and budget deficits to G.D.P. are less than 1.5%. Debt service to export earnings is now in the single digits. Egypt has made the transition to becoming a stable investment platform. The influx of FDI during the nineties attests to this as well as real GDP growth rates of 3-6%. Egypt is a member of a customs union, COMESA, which will eventually comprise 20 states with a total population of 380 million.

Morocco

With a population of 28.2 million and 55.2% living in urban centres, Morocco is the third largest market among the survey nations. Respondents surveyed considered only 10% of the population to have the purchasing power necessary to support viable consumer goods business. It has taken strong market-oriented steps in recent years, including waves of privatizations, and the modernization of its commercial law, along with the establishment of a separate commercial court. Foreign Direct Investment has flourished, particularly in textiles. The Moroccan per capita G.D.P. is US$1,244. With inflation at 1.9%, and a pegged local currency, Morocco offers up a stable economic environment, but its benefits to investors are limited by a legal and regulatory system still in the process of development.

Côte d'Ivoire

Cote d'Ivoire lies at the other end of the spectrum to South Africa being the smallest market among the countries surveyed, with a population of close to 15 million and the lowest GNP per capita among survey nations at US$710 dollars. Cote d'Ivoire has only the most basic exposure to Franchising with an estimated 20 Franchise Systems, mainly in Fast Food, Automotive Rentals and Hotels. Conceptually, Franchising is really only understood through the stand-alone retailer of exotic foreign name. As such, laws that might relate to multi-unit businesses, remain conjectural and untested. On the plus side, Cote d'Ivoire has perhaps the most liberal and market-oriented legal regimes. This is partly due to a relatively small body of law and partly due to the law's liberal, contract and business orientation. The rights of establishment are among the simplest of the survey nations. A broad range of Intellectual property is registerable. Labour and real estate laws are market-oriented. Cote d'Ivoire has stable currency controlled by a regional central bank, which serves eight CFA zone countries.

Overall assessment of the four countries interviewed is that Franchising can and does exist to varying degrees in each country.

Capacity for Capitalization

The capacity for capitalization is defined as the ability of entrepreneurs to accumulate sufficient unencumbered cash or cash equivalents to secure the total financing required to start up a franchised business.

Respondents confirmed in all three countries surveyed that general commercial lending practices required entrepreneurs to invest 33% to 50% of the total franchise investment (or a Debt:Equity Ratio of 2:1 to 1:1), including an operating line of credit for working capital purposes, in unencumbered cash or cash equivalents.

Respondents reported that 75% to 90% of Franchisees that initially inquire into a franchise do not have the necessary unencumbered investment capital to secure financing.

An exception is noted in South Africa subsequent to the Free Elections resulting in a rationalization of the public sector. According to one source, this rationalization resulted in a significant number of public sector employees to explore self-employment through franchising as a new career alternative.

The overall conclusion appears to be that the capacity of entrepreneurs to commit the necessary one third to one half of the total investment in a franchised business is low. This represents a significant barrier to growth of the Franchise Sector in Africa. Possible financing programs to address this constraint may include consideration of Cash Flow-based lending programs, Percentage of Sales premise leasing programs, "Internship" or Management Buy-Out Programs for store managers.

External Financing

The inability to secure external financing in a consistent and systematic manner was generally described by respondent Franchisors as the single most prevalent deterrent to franchise system expansion.

However, the majority of respondent Franchisors also reported that they rarely interfered in the Franchisee's business planning process or directly assisted the Franchisee in securing financing.

Conversely, members of the banking community were generally of the position that credit facilities were readily available and often aggressively promoted by lending institutions. South Africa has recently introduced attractive commercial lending programs for SMEs such as the KHULA program. The majority of Franchisors interviewed had either not used the lending program or found that the application and loan approval process was too slow to be effective.

In Egypt, the government has created a Small Enterprise Development Organization ("SEDO") as part of its Social Fund for Development ("SFD") program. A review of the SEDO mandate suggests that Franchisor and Franchisee businesses may fit its mandate quite well, with the exception of businesses having to have "export capabilities for their final products" (Social Fund for Development, Annual Report, 2000). Once again, no respondents interviewed claimed to have taken advantage of this program in their own, or their Franchisee's businesses. One study entitled "Financial Reform for Small Business Development in Egypt" (Government of Egypt, 1997) predicted the SFD would not be a viable model for achieving a self-sustaining expansion of credit to microenterprises without a considerable shift in emphasis.

The overall conclusion appears to be that potentially viable franchise investment opportunities appear to be lost due to a general weakness in communication and direct interaction between Franchisors, lending institutions and Franchisee candidates with regards to business planning and financing.

Consideration should therefore be given to establishing a more direct and formal channel of communication between Franchisors and lending institutions with regards to Franchisee financing.

Franchisors should consider a higher degree of involvement in the Franchisee's initial due diligence and financing efforts prior to executing franchise agreements. This would presuppose a degree of dialogue between Franchisors and the Banking Sector as to the lending institution's needs and requirements.

Franchisors should consider the more consistent use of "Letters of Comfort" or other such forms of assurance issued in favour of the Franchisees' lending institution in order to decrease the credit risk generally attributed to an owner/managed business. The inherent value of these Letters of Comfort is critically dependent on the financial strength of the Franchisor itself. Therefore there is a possible role to be played by governments or private risk capital companies in underwriting the credit risk associated with issuing a large number of these certificates.

Urban/Rural Mix

Franchised businesses require a minimum demographic population density to be viable. A high number of Franchisors interviewed stated that their products and services appeal to the A-B or B-C demographic profile. This profile represents approximately 10% of the total population or less. Therefore the market potential in terms of number of Franchised Systems and, by extension, the number of Franchised businesses, is limited by the size of the consumer market.

In addition, large geographic segments of Africa do not have the minimum population density required to support a Franchised business. Therefore large segments of the population currently residing in rural areas will generally not be affected by any franchise growth strategies.

Literacy

The Literacy Rate of a given African country will have an impact on the number of employees available for employment at the Franchised business level and, ultimately on any stimulation and growth of an entrepreneurial group.

Consideration can be given to the creation of "Internship" or "Apprenticeship" programs whereby employees of corporate-owned businesses may undergo a management development program that results in the eventual transfer of ownership of that business to that manager (thereby becoming a Franchisee). The potential success of this program is dependent upon the concept of "on-the-job training", which Kenneth Arrow suggests may be measured by the investment variable.

Formal / Informal Sector Dynamic

Franchising will have a long-term effect of converting the informal sector participants into formal sector participants. Informal sector participants were generally observed to be highly entrepreneurial (in the true sense of the word). Aversion to "Formal Sector" compliance appeared to be distrust of authority (governmental and business), lack of confidence in effectiveness of judicial recourse and limited investment capital. Incentives to conversion from Informal to Formal may include creating or increasing incentives to SMEs including reduced income tax rates (below a minimum ceiling), non-financial support from government agencies, etc.

Governments

Respondents in all four (4) countries were generally of the opinion that governments at all levels had a relatively low level of understanding of the principles and practices of Franchising. South Africa was a modest exception due to the continued efforts of the Franchise Association of Southern Africa (FASA). This understanding appears to be limited to the fact that Franchising as a business strategy is effective and growing; but without necessarily the understanding as to "why" or "how" it is so effective. This lack of awareness and understanding limits the government's ability to create and maintain an environment conducive to the use of franchise "best practices".

On the assumption that Governments are particularly well suited to creating a positive environment for business practices, building and maintaining infrastructure, collecting and disseminating information, and monitoring and regulating performance, various levels of government can positively affect Franchising in certain critical areas.

First, governments can ensure the legislative and judiciary process is efficient and effective so that entrepreneurs (Franchisors and Franchisees in this case) have reasonable assurance that their commitments will be enforced and their respective obligations honoured.

Second, governments should continue their efforts at creating and enforcing high standards with regards to infrastructure matters including public health and safety, sanitation and health standards relating to food preparation and service, public security, and the supply and consistent access to utilities (including clean water, electricity and telecommunications).

Third, national governments should consider compiling information on Franchise System performance for the purposes of policy making and academic research. This compilation process could be facilitated through the legislation of mandatory disclosure of prescribed information, with a filing (but no government review) requirement. As noted in Section 3, this lack of reliable information is a universal problem and is not to be construed as limited to the African context. (Lafontaine, 1995)

Finally, consideration should be given to privatizing certain areas of traditional government responsibility, some of which may also benefit from franchising. Examples may include certain aspects of health care (hospitals, clinics, home care, medical laboratories, nursing and convalescent homes and so on), education and day care facilities (pre-school, primary, secondary and technical schools), postal services, waste disposal services and public transportation. The government's role would therefore be one of regulation, monitoring performance and quality control of these sectors.

Financial Sector, Professional Bodies and Academia

In Egypt, Morocco and Côte d'Ivoire Franchising principles and practices do not appear to be generally well understood by the commercial lending institutions, lawyers, public accountants and management consultants. This lack of understanding plays a material role in inhibiting the franchise development in those countries. In practical terms, this lack of "technical" knowledge undermines the ability of Indigenous Franchisors to successfully design and expand their Franchise Systems, or Indigenous Entrepreneurs in negotiating and securing Master Franchise rights in an economically feasible manner and consequently launching the new Franchise System locally. Finally and of no less importance in the African context, this lack of technical expertise also denigrates the effectiveness of pre-contractual disclosure and "due diligence" of potential Franchisees in their evaluation of a given Franchise System.

South Africa, in contrast, is noteworthy by its relatively high level of sophistication and understanding of Franchising. The banking sector appears to be working relatively closely with government Ministries and FASA to develop financing programs specifically designed for well-established Franchise Systems and the Previously Disadvantaged Group. In addition, the Standard Bank has developed a group of "Mobile Managers" responsible to visit with bank clients and become slightly more aware of their clients' operations. There are also a few respected consulting firms who have achieved a high degree of competence in Franchising. The "Franchise Factor", produced by Franchize Directions, is a periodic "inventory count" and analysis of the Franchise Sector in South Africa, conducted over a period of years commencing in 1994. To the best of our knowledge, this is the only work of its kind that exists in Africa and, outside of North America, anywhere else in the world. Also of note is the Franchising Satisfaction Index, undertaken by Consulta Research for Finance Week magazine--noteworthy in its attempt to measure franchisees' satisfaction with their respective investments. In addition, there are a small number of public accountants and solicitors that have a significant degree of expertise in the field, but these are few in terms of numbers. Finally, there also appears to be a small group of academics that have conducted some research in the field.

Taken as a group, it is our view that these professionals represent the nucleus of an Africa-sensitive "Brain Trust" of franchise expertise. We believe there is merit to exploring how this knowledge may be leveraged to greater advantage for the benefit of other African countries.

Trade Associations

Egypt and Morocco both have small Franchise Associations. The Egyptian Franchise Development Association began in October 2001 and successfully launched its inaugural Franchise Exhibition in April of this year. Most of the respondents interviewed in Egypt and Morocco did not belong to their respective Franchise Associations. Both organizations have held franchise professional development seminars and information sessions.

Côte d'Ivoire, with less than an estimated 20 Franchise Systems operating within its borders, does not have a Franchise Association.

The Franchise Association of Southern Africa ("FASA") in many ways may be considered a working prototype of an effective Franchise Association. From its Code of Ethics and membership application process to its Franchise Advisory Council and government liaison function, FASA has exhibited leadership and the courage of its convictions with regards to promoting Franchising "best practices" amongst its members and throughout the Franchising community. It could potentially provide assistance to the emerging Associations in other African countries if there are sources of technical assistance funding.

Clearly FASA has the expertise to play a more significant role in developing Franchising throughout the continent. Especially as that expertise may be applied to developing Franchise Associations and a more viable, cohesive franchise community. However, it appears to be limited by the financial and human resources available to it, as well as the related infrastructure to fulfil that role.

Consideration should be given to the creation of a Pan-African Franchise Association comprised of national or regional Franchise Associations throughout the continent. Such an Association could facilitate franchise growth through shared expertise and resources specifically applied within the parameters of African context.

3.3. Sources of Information on Africa

Overview

During the course of our survey, we conducted 75 interviews with Franchise Systems (including 8 Franchisees in South Africa), 5 interviews with various lending and financial institutions, 13 with government bodies and consulting groups and 21 with law firms. Interviews with Franchisees were sought when possible to juxtapose any bias that may be inherent in Franchisor responses. We were unable to interview any Franchisees in Egypt or Morocco. Surveys are scheduled to be conducted with 6 or 7 Franchise Systems in Côte d'Ivoire subsequent to the presentation of this paper.

South Africa

In South Africa, a total of 45 interviews were conducted with Franchise Systems, 8 of which were with Franchisees. The sample distribution by industry included 5 interviews with Retail Systems, 6 interviews with Automotive, Building Products and Home Services, and 14 and 20 interviews with Business-to-Business/Education and Training and Food service (Fast Food and Full Service) Systems respectively. The sample represented 17 Emerging Systems (less than 20 Franchisees), 7 Mezzanine Systems (Between 20 and 60 Franchisees) and 13 Mature Systems (greater than 60 Franchisees). The 8 Franchisees interviewed were from Mezzanine and Mature Systems (4 each respectively).

According to the Franchise Factor 1999/2000, 82% of Franchise Systems are indigenous to South Africa. 18% of the Franchise Systems that originate from offshore have been established through Master Franchise arrangements. 56% of Franchise Systems have embarked in international expansion programs of which 44% is within Sub-Saharan Africa and 5% is north of Central Africa.

Of the Franchise Systems we surveyed, 40 were indigenous to South Africa and 5 were from the United States. 3 respondents were Multi-Brand Franchisors representing 11 separate Franchise Systems collectively. Significant trends were noted in "Branchizing" (Pick'n Pay, Woolworths and PG Autoglass) and "Conversions" (The Extra Mile and Hi-Q Automotive).

Egypt

In Egypt, a total of 23 interviews were with Franchise Systems, none of which were with Franchisees. The sample distribution by industry included 8 interviews with Retail Systems, 2 interviews with Automotive, Building Products and Home Services, and 4 and 9 interviews with Business-to-Business/Education and Training and Food service (Fast Food and Full

Service) Systems respectively. The sample represented 15 Emerging Systems, 3 Mezzanine Systems and 5 Mature Systems.

10 of the Franchise Systems interviewed are indigenous to Egypt and the Middle East while 8 Franchise Systems were from the United States and 5 were from Europe. 7 of the 15 Franchise Systems that originate from offshore have been established through Master Franchise arrangements. No information was available as to how many, if any Franchise Systems have embarked in international expansion programs.

1 respondent was a Multi-Brand Master Franchisee representing 2 separate Franchise Systems and both of which subsequently failed in the Egyptian market place.

Morocco

In Morocco, a total of 7 interviews were with Franchise Systems while one of which was with a Franchisee. The sample distribution by industry included 1 interview with Retail System, 3 interviews with Automotive Services and 3 other interviews with Food Service Systems. The sample represented 4 Emerging Systems, 1 Mezzanine Systems and 2 Mature Systems.

Two of the Franchise Systems interviewed are indigenous to Morocco while 3 Franchise Systems were from the United States and 2 were from Europe. Four of which that originate from offshore have been established through Master Franchise arrangements. One franchisee was licensed directly from the European franchisor. None of the indigenous franchise system has embarked on international expansion.

One respondent was a Master Franchisee of a prominent American Franchise System that subsequently failed in the Moroccan market place. 2 other American Franchise Systems were also brought to our attention as failed concepts although we did not have the opportunity to interview the former Master Franchisees.

Brand Value of Existing Systems

The Brand Value of Franchise Systems was defined in two fashions: Consumer Brand Value and Investor Brand Value.

Consumer Brand Value

Consumer Brand Value is assumed positive if there is positive growth in the average annual sales revenues of franchised businesses, the number of months it takes a franchised business to break even and the average number of years it takes a franchised business to mature. The implicit assumption is that an increasing number of customers (both new and repeat) will result in increasing sales revenues, an acceptable length of time to breakeven and thereby lead to investor demand for new franchised businesses. The average annual unit sales increase to maturity was reported as 23%. The average number of months to break even was calculated to be 13 months and the average number of years to maturity was calculated to be 2.80 years. It would have been preferable to compare these numbers to country equivalencies for SMEs, but these numbers were not available. Anecdotal evidence in North America would suggest the equivalent numbers would be 10% to 15% sales increase per year, 12 months to break even and 3 years to mature. Consumer Brand Value can therefore be assumed to be at least equivalent to North American levels.

Investor Brand Value

Investor Brand Value is assumed positive if there is a positive growth in the total number of franchised businesses per year –reflecting demand by entrepreneurs to join the Franchise System, and the percentage of Multi-Unit Franchisees to total Franchisees – being evidence of the financial attractiveness of the Franchise System by an existing Franchisee re-investing to acquire new Franchised Units. The total number of new franchised businesses opened per year on average was 7.7, with the highest growth rate being experienced in the food service sector at 14.7 in South Africa and the lowest being 1 unit in the automotive sector in Morocco. The average number of Mult-Unit Franchisees per System was 18.5 %, again with the high being in South Africa with 27% in the retail sector and the low being in Morocco in the automotive sector at 5.5%.

One may postulate from these correlations that an increased presence and thereby awareness of Franchising opportunities, products and services leads to an increased demand for those same franchised businesses and their related products and services. The “Cluster Theory” as applied in the Franchising context supports this position. Increased awareness and technical expertise in Egypt and Morocco should therefore have a positive effect on Investor Brand Awareness.

Capacities and Potentials for Expansion

Within Countries of Origin

South African Franchised Systems have grown by 17% a year since 1994. In Morocco, the number of new systems has grown by 73% over the last 3 years. In Egypt, the number of American fast food chains almost quadrupled over the last 5 years. The Franchisors or Master Franchisees in those countries have therefore demonstrated the ability to achieve growth at least within their respective countries. In addition, the global marketplace appears to offer an abundant number of Foreign Franchise Systems that could be potentially imported to African countries.

Also noteworthy was the observation of independently owned and operated establishments that seemed to be crowded and well favoured by local consumers. This is evidence of local businesses that could be franchised if they were aware of the Franchising option. However, the degree of capitalization required to properly franchise an independent business operation will be a predictable barrier to entry. The costs associated with creating and developing Franchisor-specific business plans and economic models, Operations and Training Manuals, Franchise Management Information Systems, legal documents and marketing materials can often prove to be daunting to the would-be Franchisor.

Outside of Country of Origin

As cited earlier, 56% of Franchise Systems indigenous to South Africa have expanded internationally, of which 44% have restricted themselves to Sub-Saharan Africa. As noted in Section 3, the two strongest corollaries to international expansion are the degree of indigenous competition and market share growth and cultural commonality between Indigenous and Foreign countries. The number of South African Franchise Systems that expand internationally will therefore predictably continue to grow as the South African market place becomes more competitive and growth begins to slow. Further, expansion to predominately Anglo-Saxon nations will represent the least risky mode of expansion

Managerial, Technical Or Methodological Issues

Survey results in the area of Operations Manuals, training and support indicate that Franchisees appear to be receiving at least the basic level of knowledge necessary to operate a franchised business successfully. Supporting evidence includes the low incidence of franchised business failure, attractive return on investments (>25%) and overall unit growth of new Franchisees.

However respondents specifically noted three areas as requiring more skills development. These skills or techniques were in the areas of business planning, and financial planning and Management and Franchisor/Franchisee Management Information Systems and diagnostics.

FASA represents approximately one third of the Franchise Systems in South Africa. This is also reflective of the relative memberships in the Egyptian and Moroccan Franchise Associations. Hence the majority of Franchise Systems do not avail themselves of whatever professional development opportunities exist.

3.4 Potentials for the Growth of Indigenous Franchising in Africa

Overview

In addition to attracting established international franchise systems to enter African markets and encouraging indigenous franchise systems to open more units, the researchers believe there is a degree of potential in Franchising existing businesses.

Franchising of existing owner-managed businesses has the greatest potential given the volume of independent, largely family-operated SMEs that currently exist.

"Branchising", defined earlier as the process of converting a chain store operation into a franchised operation by selling corporate owned and managed retail outlets to Franchisees, also provides a potential vehicle to create entrepreneurship. Recent examples in South Africa include Pick'n Pay, Woolworths and PG Autoglass.

"Conversions", defined as the transformation of an independent owner-managed business to a Franchised business, is also a growing trend. The independent entrepreneurs are attracted by a perceived increase in marketing and advertising strength. This is achieved by joining a proven brand with an advertising fund to promote it. In addition, conversion Franchisees hope to benefit from reduced or at least stable cost of product by taking advantage of the Franchise System's economies of scale. This trend was noted in South Africa with The Extra Mile and Hi-Q Automotive.

Benefits to the Economy:

Existing indigenous businesses have, as a function of their creation, knowledge of the specific, local market demands and have a proven product to be offered to consumers and a proven business format to offer to future Franchisees.
Hence, indigenous Franchising should, ceteris paribus, prove more attractive to local consumers, be less sensitive to the need for product testing and adaptation in African markets, result in shorter Gestation Periods and lower failures rates.

Low Capitalization / High Demand Franchise Concepts

According to the Franchise Factor 1999/2000, the majority of existing Franchise Systems in South Africa cater to the top 31% of the demographic market. There is a clear demand for the application of Franchising practices to those businesses serving the majority of the population. This observation is equally valid for the other countries surveyed. In addition, consideration should be given to low capitalization businesses that could be more easily financed with smaller amounts of unencumbered cash.

Retail concepts catering to low demographic markets may include:

- Grocery
- Home Hardware and Renovation Centres
- Automotive do-it-yourself repair depots
- Fabric Stores
- Second-Hand Clothing, Appliances, Vehicles, Computers, Medical Equipment, etc.
- Mobile fast-food and restaurants (Street Vendors with commissaries)
- Mobile automotive services and products (Towing, Repair)
- Transport services, health and education services

Service industry concepts with low capitalization thresholds may include:

- Personal Security and alarms
- Transportation (Taxis, Trucking, Courier)
- Travel and Tourism
- Business planning and management, accounting and tax services
- Temporary Personnel Placement Services (Professional/Management & Clerical/Labour)
- Construction Trades and "Handy Man" Services
- Business Network Franchises
- Business Support Centres (Incubation Offices)

"Special Interest" Franchised Systems

Governments may consider the relative advantages of privatizing certain traditionally public domain functions, including the following.

- Health-Care Services (Walk-In Clinics, Home Health Care, Hospitals, Dentistry, Medical Laboratories)
- Education services (Supplemental, Primary & Secondary Schools, vocational training, skill-based training)
- Child Care and Support (In-Home Day Care)

Conclusions

Examples around the globe provide us with ample evidence that Franchising can be successfully applied to industries, products and services specific to the needs of Africa.

4 THE CONTRIBUTION OF FRANCHISING TO ECONOMIC DEVELOPMENT IN AFRICA

The goal of the analysis in this section is to examine what contribution Franchising may have made to the economic development of the three African countries, which are part of our sample. This analysis is based on the questionnaires and interviews taken in 52 franchise systems in South Africa, Egypt and Morocco. Here, as in other parts of the study, we realize that the choice of these countries is biased in favour of Franchising, because it is more developed in these countries than in most other countries of the African continent. The number of firms varies according to the question, because not all firms answered the full set of questions included in the questionnaire. To keep this paper concise, only the conclusions are reported here, without much explanation of the underlying theory and background. For a more detailed discussion and results, the reader is referred to the forthcoming full report of the study.

4.1. Overview

The main contributions of Franchising to past and future economic development in Africa can be summarized as

(1) the generation of entrepreneurship,
(2) the transfer of technologies and know-how,
(3) the growth of the small and medium (SME) enterprise sector,
(4) the creation of direct and indirect employment,
(5) the enhancement of foreign exchange earnings and
(6) Contribution to poverty reduction.

These points represented our working hypotheses. Based on the data collected from about fifty franchise systems in South Africa, Egypt and Morocco, we conclude that there is some supporting evidence to each of these hypotheses, although at different levels of strength.

4.2. Promotion Of Entrepreneurship

The essence of entrepreneurship consists of three characteristics of entrepreneurs: employment creation, risk taking and innovation. We have found evidence supporting the assumption that all three characteristics can be observed in Franchising.

The creation of employment in the franchised segments of four sub-sectors of the economy (restaurants/fast-food outlets; retail services; automotive, home and building services; and business-to-business, educational and training services) is evident in the exponential growth of franchise units and the number of their employees. Ideally, we would have compared their employment growth with that of the corresponding non-franchised sections of the economies. If franchise growth exceeded that of non-franchised business, this would have been taken as evidence of Franchising to be an engine of employment growth. However, the detailed data for this proof were not available. Therefore, we have taken the evidence of exponential growth as an indication of a positive contribution to employment growth.

Exponential growth is an increase by accelerated pace, rather than constant increments. The presence of exponential growth in the franchise sector was not only observed in a study by ABSA (2000) for the South African Franchise Association, but we also observed it in our sample of South African firms. On theoretical grounds it is expected, due to the "snowball" effect typical of franchise systems. When Franchisors conclude contracts with Franchisees, the latter may be expected to generate new enterprises of their own, either as master Franchisees, or by becoming multi-unit Franchisees. The average number of outlets generated by Franchisors in our sample was 7.7 per year, with a high of 14.7 in the food services in South Africa. From this number we have excluded all conversions from existing businesses into franchises in order to capture the true addition to employment. The corresponding average growth of employment during a twenty-year period was 32.3 direct and 109.3 semi-direct jobs per year, where direct refers to the number of new employees of the Franchisors (including corporate-owned suppliers), and semi-direct employment refers to the total of employees of all Franchisees.

Risk taking, the second characteristic of entrepreneurs, is most strongly borne out by multi-unit franchises, which are represented in a proportion of 18.5% of the sample. This feature has also been referred to as a sign of advanced entrepreneurship. The presence and growing importance of it in the franchise sector is taken as another indicator of risk-taking behaviour and enhanced entrepreneurship.

The third characteristic of entrepreneurs, their propensity to innovate, was most obvious in our sample by the high proportion of domestic Franchisors. Innovation in this context refers to the introduction of new business concepts, products and services, but also to the introduction in particular markets of existing concepts with the necessary adjustments to the local demand conditions. Our survey has provided substantial evidence of the existence of both of these manifestations of innovative activity.

4.3 The Transfer Of Technologies And Know-How

While innovative activities, and thereby entrepreneurship, were defined here to include the adoption of existing business concepts, the latter are clearly at the centre of technology transfers. Traditionally, technology transfers refer mainly to the granting of ownership of proprietary product and process designs. This can take the form of licensing or purchase, but the most important part of the transfer process is the transmission of knowledge and know-how. Franchise agreements typically include both, the transfer of ownership and the transfer of knowledge.

In the majority of franchise systems we found that the contract includes the transfer of all elements of knowledge required for the setting up and operation of the franchised business. These elements are the knowledge of the products and services supplied, of advertising and marketing, operation, business planning, financing and accounting. However, we have only incomplete information as to the completeness of the transfers as seen from the recipients' point of view.

The effectiveness of knowledge transfers depends not only on the completeness of the set of knowledge elements transferred, but even more on the efficiency of the transfer mechanisms chosen and implemented. The modes of transfer include documentation, such as operations manuals, but also training courses provided by the franchise to the personnel of the Franchisee, and periodic visits with the provision of advice on the pursuit of business. The average length of training provided was found to be in the order of seven weeks and the average frequency of field visits of the franchise units was recorded as 2.6 per month. While training periods are longest in the business and educational sub-sector (11 weeks) and shortest in retail services (4.3 weeks), the greatest frequency of support visits (4.4. per month) was found in the automotive, home and building service sub-sector.

For technology transfers to be economically efficient, the benefits have to outweigh the costs. The benefits consist of the ability of the recipients to successfully operate the business, which normally translates into higher gross and profit margins. The costs of the transfer to the recipients include the franchise fee, the royalties and other indirect payments for specific services, such as advertising or rebates for material purchases that are retained by the Franchisor.

Concerning the benefits as reflected by higher profit margins, the survey revealed that the gross margins reported were on average 51%, with a high of 59% in the food service sector and a low average of 32% in the automotive & building services industry. Rates of return were found to average 32%, which is substantial. Although, we have no reliable data from the corresponding non-franchised sub-sectors, our respondents, including the Franchisees, often claimed that their margins and rates of return exceed those of the non-franchised competitors.

As to the cost of technology and knowledge transfers to the Franchisees, average franchise fees were found to be $25,000 and the average royalties in the order of 7%.

4.4. Growth Of The Small And Medium Enterprise (SME) Sector

The speed of enterprise creation has already been described in the context of entrepreneurship. It is useful to emphasize that most franchises fall into the category of SMEs. It is also clear that SMEs are all part of the private sector, so that their growth contributes to the growth of the private sector. The criterion of exponential growth observed in the context of entrepreneurship promotion, therefore also applies to the growth of SMEs. This must be interpreted as a positive contribution of Franchising to economic development because a strong SME sector is the breeding ground of new entrepreneurship and because it is well adjusted to satisfying diversified demand for goods and services.

An important aspect of this (SME) sector is the fact that it includes a lot of informal-sector activities, which every government has an interest in transforming into formal or modern-sector activities. Franchises, however, are very much formal sector creations, as they rely on a legal framework to enforce contracts. This fact emphasizes the role of Franchising in formalizing parts of low-income economies that tend to be informal. This process of strengthening the formal SME sector takes the form of closing-down of non-franchised businesses, but also that of conversions into franchises. We have found evidence of both such forms of substitution.

4.5. More On Employment Creation

While the creation of direct and semi-direct employment has already been described as a feature of entrepreneurship, indirect employment creation is also to be attributed to franchises. It can take various forms, up to the general multiplier effect based on income growth. In the present context we limit the analysis to backward linkage effects. Franchises contribute indirectly to employment creation if they purchase preponderantly domestic rather than imported goods and services. In our survey we have attempted to quantify this aspect of the total economic impact of Franchising by inquiring the proportion of local intermediate purchases. Although certain franchises seem to rely strongly on imported purchases, the vast majority of them rely on local supplies. There is, therefore, a certain positive contribution to employment via the backward-linked supplies of local origin.

Finally, employment creation can also be approached from a more aggregate perspective. It depends on the average labour/capital ratio or the corresponding inverse of investment per employee. In our survey this ratio was determined to average 0.2 persons per $1,000. This number represents evidence of clear labour intensity of Franchising.

4.6. Foreign Exchange Earnings

The issue of foreign exchange earnings is important from a macroeconomic perspective. Many less developed countries suffer periodically from excessive external deficits because they strongly rely on imports, especially for investments. This is caused by the typical weakness in the production of capital goods, a structural feature of lower levels of development. To overcome this weakness, outward-oriented trade strategies are considered as more beneficial than inward-oriented ones.

Franchises can contribute in two ways to foreign exchange earnings, either by exporting goods or services, or by extending franchises to foreign countries, which then receive foreign royalty payments. Our survey revealed that the majority of franchises in the sample do not export. Less than 20% of them export goods or services. About the same proportion of them reported to generate foreign exchange earnings by extending their franchises to foreign countries, most often neighbour countries. Their total contribution to this kind of economic benefit is modest, although not insignificant.

4.7. Poverty Alleviation

Whether Franchising makes a contribution to poverty alleviation depends essentially on its record of employment creation. This argument is based on the fact that most poverty is a result of unemployment or under-employment. Admittedly, most of the poverty in Africa exists in rural areas, where Franchising is less prevalent. However, the large urban agglomerations are also known to have important pockets of poverty, which is the consequence of migration based on unfulfilled prospects of urban employment. Our earlier conclusion of exponential employment growth can therefore be taken as evidence of some positive contribution to poverty reduction. From a more critical viewpoint one may argue that the urban job promises could reinforce rural-urban migration and thereby aggravate urban unemployment and poverty, a hypothesis suggested by the Todaro migration model (Todaro, 1969). Modern sector wage levels are seen as a cause of this phenomenon and the resulting economic dualism. Against this view, it can be argued, however, that the incomes generated in franchises are typically not at the higher end, so that their impact on wage expectations is probably quite modest. In that sense, the contribution of Franchising to poverty reduction is likely to be positive rather than negative.

4.8. Economic Obstacles To Franchise Development

Some of the more general reasons for the low level of franchise development in Africa are likely to lie in low income, the high proportion of the populations living in rural areas, and the relatively low participation of women in formal labour markets; these hypotheses have not been tested, however, as far as we know. Among the more specific obstacles to franchise development we have identified three issues, which could possibly be remedied by policy initiatives.

First, the knowledge of Franchising, especially of business format Franchising, is still very limited in the African business community. The diffusion of information about Franchising, its functioning, benefits and costs, towards the business sector in general and towards financial institutions in particular was repeatedly identified as an area of useful government and private sector intervention.

Second, the financing of the initial investment by potential Franchisees is often the greatest obstacle to launching a franchised business. This constraint may be alleviated by creating special opportunities for business loans to Franchisees, which are considered less risky than non-franchised ones.

The legal and regulatory environments were also mentioned as obstacles to franchise development. This was rarely the case in South Africa, but more often in Egypt and Morocco.

5 LEGAL AND REGULATORY FRAMEWORK

5.1. Survey Design

To answer the question of what impediments exist to Franchising due to the legal and regulatory systems in African nations, we surveyed franchise lawyers, government officials and officials of trade or franchise organizations in the four African nations of South Africa, Egypt, Morocco, and Côte d'Ivoire, each representing differing levels of market size and franchise development. South Africa would be termed a large and thriving franchise marketplace, Egypt a large nation with a low to medium level of franchise development and Morocco a small market showing early signs of Franchising, and finally, Côte d'Ivoire, is a small market with almost no exposure to Franchising. In all, 21 lawyers were surveyed and information interviews were conducted with franchise industry personnel and government officials. In almost all cases, the actual interviewees were from among the most experienced practitioners of their respective countries, either in the franchise area or international business law.

Since all of the survey nations have already had foreign franchises established, the absolute means to establish franchises existed in each. The question becomes one of degrees, ascertaining the added legal and regulatory costs that would burden a transaction. This cost could come in many forms. The Franchisor might have to pick a means of structuring the transaction that delimited its strategic options, perhaps choosing a master Franchising deal over a preference for direct Franchising, or conversely, be forced to make a direct investment in a host nation. It might be in the nature of added risk to the project due to lengthy delays in the courts or the general lack of enforcement of laws by local authorities. The nature and degree of uncertainty and its effects were considered.

The survey investigated 17 separate areas of the law. These were:

Legislation directly affecting Franchising,	Product liability issues
Legislation pertinent to foreign Franchisors	Securities law
Anti-trust or competition law	Real estate
Restrictive covenants or covenants not to compete	Labour laws and employment practices
Trademarks and Other Intellectual Property Customs and import/export controls	Nature of judicial system Immigration and other matters
Foreign exchange controls Taxation issues	Franchisee rights Availability of incentives from governments/NGOs
Legislation directly affecting Franchising,	Recommendations and Suggestions

5.2. Basic Assumptions in Questionnaire

Primacy of Contract

Franchising has evolved in developed economies combining the use of contract and statutes. Contracts, such as location lease agreements and the franchise agreements, are central to Franchising. A liberal legal system, one that defers to the primacy of contract in governing a relationship, is a natural ally to Franchising.

Property Rights

Contracts need the building blocks of statutory devices such as trademark and patent laws. These guarantee title to the real, personal, and intellectual property that makes up a franchise system. More and more, Franchising relies on newer and subtler forms of intellectual property, such as know-how and trade dress. The latter arose from the practice of branding businesses through the use of colour schemes, staff uniforms, and specially printed packaging and stationary. Know-how is the intangible catchall of methods for carrying out a service, preparing product, or the running of the business. It is protected by means of contract and evidenced by use of manuals supplied to the Franchisee marked, “On Loan”.

Not only must property be defined and registerable, it must also be protected by enforcement. Franchisors will want to protect their system from appropriation. To do this, they need the enforcement of non-compete clauses against current and former Franchisees. They also need courts to prevent the use of its system, or parts of their system, by others.

Judiciary

Once a contract has been drawn up, and property demarcated through legislative devices, a reliable court system would be needed to interpret and guide agreements; a sheriff’s office or police force would be needed to enforce them. Although reliance on a judiciary could be limited by use of an arbitration agreement, courts would still come into play registering judgements, and/or enforcing judgements. The courts need to be expeditious and judgements need to be sound, unbiased, and enforceable. The courts, in effect, guarantee the worth of any agreement.

National Treatment

Each new legal and regulatory environment also raises specific concerns. Franchisors would certainly be concerned about any differences in treatment to foreign corporations and nationals. Not only could such differences create added establishment costs, they could affect the long-term competitiveness of the Franchisor.

Body of Law

Since Franchising requires a great deal of interplay between many different areas of law, international Franchisors would likely examine a variety of legal areas. Besides the areas of property law, labour, import, and exchange controls could significantly impinge on the Franchisors' operations. Exchange controls in particular, are likely to affect the mode of local establishment. Any laws regarding limits to repatriation of profits would factor highly into the feasibility of a project.

Incentives

The survey also ventured into asking if each respective country had any programs to encourage foreign Franchisors or by which franchise businesses might be established. Given the hypothesis that certain regimes would be more attractive to a Franchisor, the study ventured to question if incentives and other forms of active governmental encouragement had played any role in attracting Franchisors.

Establishment Practices

International Franchising has over the years created a body of precedents by which Franchisors have established in other jurisdictions. The nature of international transactions places demands on Franchisors, to some degree in common to all international investments. And while the particular needs of Franchising place certain additional burdens on a transaction, Franchising itself has advantages over other forms of investment, since local country partners can help to reduce the risks associated with entering an unknown market environment.

5.3. Country Summaries

General Observations

The general conclusions that can be drawn from the four-country survey are that all of the countries had the basic framework of laws necessary for Franchising. All had the Intellectual Property laws that form the core of Franchisor property, such as patent, trademark, and copyright. All were somewhat weaker in the protection of newer forms of property that have developed largely through Franchising, such as know-how and trade dress. All had opened their economies to foreign investment, and though all, except Egypt, had somewhat complex systems of foreign exchange, none presented any significant problems to establishment.

But Franchising, unlike older forms of business, relies heavily on the good graces of a supportive and efficient legal and regulatory system. Except South Africa, all have continuing problems with their judicial systems. Egypt and Morocco also have complex and slow bureaucracies. Except South Africa, all posed significant questions as to the functioning of their enforcement systems. While the barriers posed by non-enforcement are perhaps fatal in Côte d'Ivoire, they are still significant in Egypt and Morocco.

Individual Country Summaries

South Africa

South Africa offers a business environment similar to that found in Franchising nations such as the U.S. and Canada. A foreign Franchisor has a full range of strategic options. It can operate a branch office, a wholly owned subsidiary Franchisor, a joint venture, or license a master Franchising agreement with a local partner. The latter is the preferred method. South Africa's intellectual property laws are stringent and straightforward, and very much in line with the level of protection offered in franchise exporting nations. Items of coverage include copyright, trademark, patent, trade secret and trade dress protection. Movement and work in South Africa by a Franchisor's employees is controlled by means of visas but this was not flagged as a problem by the interviewees, presumably due to a sufficiently expeditious immigration service. In most areas of law such as, tax, product liability, employment, real estate, South African law is similar to laws found in Franchising nations. South Africa, as a new franchising nation, conveys a sense of legal and regulatory continuity with developed Franchising nations.

Franchise Specific Legislation and Industry Association

South Africa has the only legislation dealing directly with Franchising among the survey nations. It has a government legislated code of ethics which is mandatory upon all Franchisors, and a more stringent code applicable to Franchisors who are members of the Franchising Association of South Africa (FASA). Besides providing this service to its Franchisor members, FASA also serves the needs of promoting the industry in South Africa, acting as information clearing house for potential Franchisees as well as an advocate for the industry as a whole.

Intellectual Property Concerns

Interestingly, while know-how can be contractually protected, with fully five of six lawyers in agreement, only two felt that restrictions to know-how's use would be enforced outside the context of a non-compete covenant. The court seems averse to attaching property rights to know-how after termination of an agreement, possibly due to its less concrete substance in relation to registerable property such as patents. Some of the interviewees also pointed to a pro-employment bias in the courts, which would regard disfavourably hindrances to a person's ability to earn a livelihood. But non-compete covenants given by a Franchisee, for the duration, and after the expiration of an agreement, are enforceable (four said yes, and two stated no). And as is the normal course in Franchising nations, South African courts would delimit any non-compete clauses within length and territory bounds, which are set by the Competition Act. On the topic of trademarks, these present an unusual difficulty with regards to the length of time taken to process applications, currently, upwards of three years.

Foreign Exchange and Loan Capital

Foreign exchange laws give power to The South African Reserve Bank to review royalty agreements. But the percentage range on most royalty agreements upon a master franchise agreement, are below the reviewable threshold. Problems could arise for certain North American Franchisors of services, such as education learning centres, who typically carry royalties as high as 10-15% of gross revenue. The bank is regarded as responsible in using its powers. While pre-approval is available for agreements, it is recommended by only a minority of interviewees (most thought that problems should be dealt with as they arise).

Judiciary, Functional and Regulatory System

South Africa's judiciary received top marks for fairness and speed. The country's lawyers expressed confidence in the rule of law. The lawyers themselves were informed about the law, and perhaps as a function of greater experience with Franchising, there was greater uniformity to answers to survey questions.

South Africa's lawyers also expressed faith in the regulatory mechanisms that oversee and enforce its laws. They conveyed a sense of ease, underlining the matter-of-factness of most bureaucratic processes. The role of the bureaucracy seems to be onside with the needs of the market.

Cote d'Ivoire

Legal and Regulatory Uncertainty is High

Cote d'Ivoire's legal and regulatory environment is fraught with uncertainty. Part of this uncertainty is based on an almost complete lack of experience with Franchising among lawyers and the legal system. Overarching these problems is yet a greater difficulty faced by investors in the general lack of enforcement of laws or contracts due to weaknesses in the regulatory adjuncts to the legal process.

Franchising is Undefined

Franchising is not understood as a unique business concept. But since Côte d'Ivoire is market-oriented, a notion of primacy of contract exists, and since the intellectual property laws are all in place, there is no reason a franchise arrangement couldn't be executed. Since dealerships exist, a franchise agreement would exist as a complex species of a dealership agreement. What remains theoretical is how a court would interpret complex performance and default provisions, beyond those found in dealership agreements.

Competition and Anti-Trust Laws

Since Franchising invokes tied selling, exclusive supply arrangements, and customer and territory restrictions and other practices which could appear to be restraints on trade, the Ivorian lawyers were unsure if these laws might not prove impediments. While Côte d'Ivoire does not have a comprehensive competition/anti-trust act, it does have individual laws that deal with restraint of trade. Competition legislation, as it is defined in North America and South Africa, usually exclude practices from review that ultimately enhance market efficiencies. An economic reasoning underlies the purpose of a competition/anti-trust act. To emulate this, a Franchising agreement in Côte d'Ivoire could explain the economic rationale of any seemingly restrictive practice within its preamble.

Legal and Regulatory System Still in Development

Along with interpretative uncertainty of its various laws, Côte d'Ivoire's judiciary and regulatory system carries uncertainty about its basic functions. While the courts are seen to be operational, the outcomes are not regarded as impartial nor is the training of judges regarded as adequate. And while Côte d'Ivoire boasts a legal regime with a decided market orientation, without the underpinnings of fairness in the judiciary, the system may not be able to underwrite its promise to business. Perhaps more fatal to Franchising, a general lack of enforcement of laws makes these and other barriers to Franchising almost academic. At this point, an alternative to courts such as mandatory arbitration would be advisable. Other self-help remedies might also be needed in place of police or sheriff services.

Morocco

Franchising exists in Morocco in its early stages. The legal and regulatory environment is amenable to Franchising, but as in the case of Cote d'Ivoire, the concept is not well understood. While Foreign Direct Investment has made Morocco amenable to foreign investment in general, and hence operating a subsidiary is relatively straightforward, the dangers of judicial misunderstanding of Franchising remain. Morocco is very much in legal transition. New acts have been promulgated for securities and anti-trust/competition, and their future relationship to Franchising is unknown. Eventually, such legislation could help to define 'good' Franchising practices. But for now, they pose some dangers of being misapplied to Franchising, since, likely, they were formulated without taking Franchising into account.

In other areas of law, to date, the statutory rights of an employee exceed the norms found in Franchising nations. The Moroccan legislature is currently considering re-aligning its labour laws towards a market orientation.

Judiciary

Moroccan courts and its enforcement apparatus have made strides to becoming efficient and effective. On the one hand, court cases are not interminable, estimated to take one to two years, and injunctions are regarded as effective, but on the other hand, the system continues to battle corruption. More training for judges is desirable according to most of the interviewed lawyers. And while in a general way, the courts are seen to be fair by three of the five, bias is regarded as likely in matters involving politically strong players. The hesitancy of interviewees to discuss issues of fairness belied perhaps the need for caution more than might appear from their answers and perhaps the need for alternatives such as arbitration.

Anti-Trust Clarification

As in the case of Côte d'Ivoire, Moroccan lawyers had not dealt with multi-unit franchises and did not know the results that would follow from Franchising's ultimate contact with their new Competition Act, which has newly been enacted.

Intellectual Property Legislation

Morocco has a good range of Intellectual Property provisions, being a signatory to the Paris Convention. There is a shortfall of protection in concepts such as know-how and trade dress. But these types of property could conceivably be protected by contract and the courts seem amenable to primacy of contract. Four of the five interviewees felt such covenants were enforceable and injunctions were felt to be timely and effective.

Labour Laws

Labour laws are employee-biased, but these are currently under review. Currently, the dismissal of an employee presents serious difficulties and may involve significant severance remuneration.

Supporting laws

In all of the areas of law, dealing with Real Estate, Tax, Product Liability, Morocco is aligned to liberal expectations. It is only in the areas of foreign exchange and labour that some concerns arise. Foreign exchange, though not straightforward, is navigable with proper legal guidance.

Education Needs

The interviewees were clear that the greatest need for Morocco is a better understanding of the workings of Franchising for all parties. Some felt a regulatory framework was needed to help clarify the rights and obligations of contracting parties. Others mentioned education for local entrepreneurs. All agreed that foreign Franchising was limited by the initial cost imposed by the

Franchisor. Whether they felt that cost was magnified by legal and regulatory uncertainties is unclear.

Egypt

All together, the successful stabilization of the economy, the growing affluent consumers, may be working to draw Franchisors, but an institutional environment, still grappling with its central planning past, may has given them pause. While the books have been balanced, the changes necessary to turn Egypt's formerly centralized institutions towards a market-orientation have not yet born fruit. The courts are not considered efficient to the degree to serve Franchising. The enforcement mechanisms are seen to be slow and sometimes unreliable. The newly enacted commercial code of 1999 has been brought ostensibly to liberalize commerce, and to accommodate foreign direct investment, and yet it seems to, oddly, take a step back. By reducing protection to technology licensing, it makes international Franchising that much more unlikely.

Judiciary

Egypt's judges are generally perceived as fair according to a slim majority of three to two lawyers. The backlog in Egypt's courts is the highest of the survey nations, with a very general estimate being 2-3 years and upwards. Injunctions are regarded as neither timely nor effective by four of the five lawyers, again, numbers unmatched by any other survey nation. In summary, some corruption but more delays and lack of effective action make Egypt's judicial system a strong liability and a serious obstacle that must be overcome with judicious use of arbitration and self-help enforcement remedies.

Technology Licensing

By Egypt's new commercial code, the transfer of technology has been made free and clear of any significant continuing control by the seller. Disallowed are production controls on quantity or provisions relating to equipment modification, and even the requirements of labelling or trademarks on product. Hence, licensing is not feasible. The issues this law addresses quite possibly stem from the manufacturing sector. Technology is made to serve the purchaser, and to prevent, in essence, the seller from making the local buyer into a proxy. The only route left open to a foreign franchise would be establish locally, and license directly with the parent. It could keep discipline on Franchisees through lease of equipment rather than technology.

Intellectual Property

While Intellectual Property is fully protected, within the categories defined by international agreements, such as trademarks, patents and copyright, the same protection does not extend to less concrete properties. Three of the five Egyptian lawyers did not feel, know-how, could be protected, while two thought it could. The same situation exists for trade dress, and likely, this is not a term often encountered by the legal system. On the plus side, a majority of four felt that covenants restricting competition and those restricting use of, know-how, were enforceable.

Implied Warranties on Agreements

Three of the five lawyers felt that implied warranties could be read into a franchise agreement while two thought this would not happen. Perhaps due to Egypt's history with centralized planning, the implications are of a more interventionist court, and hence some doubt is cast about the primacy of contract in Egypt. As with Morocco there is a danger of interpreting contracts outside the context of the norms of the Franchising industry. To create this context, the preamble of an Egyptian franchise agreement could more fully explain the nature of the Franchising relationship and its rationale.

Labour Laws

Perhaps the greatest legacy of Egypt's central planning is the nature of rights that attach to employment. Employees are easy to hire but very difficult to terminate, requiring the services of a local conciliation council. Any foreign Franchisor would need to consider human resources as on par with other less liquid resources such as land. Some exemptions exist to labour laws within specific FDI investment vehicles such as law 8 of 1997. Additionally, the matter of reform is currently before the Egyptian parliament.

Foreign Exchange

Egypt has simplified its foreign exchange laws to the extent that its currency can be freely exchanged through private dealers. It has removed ceilings on repatriation of investment and profits and even capital gains. There are still some requirements to keep Egyptian Pound accounts for establishment purposes. The caveat to this sweeping liberalization is that occasional shortages in foreign currency can mean no freely traded currency is available in exchange for Egyptian Pounds.

Real Estate

Egypt's lawyers were not too clear whether a defaulting Franchisee's lease could be assumed by the Franchisor. Two lawyers felt this could not happen and three were unsure. The situation that creates doubt may be related to when a Franchisee is also the owner of the real estate in question. Proper registration of the property with head lease to an incorporated entity may eliminate this problem.

Import of Supplies

Egypt has a complex set of import requirements, with one lawyer mentioning 25 individual steps to approval for import of items. Egyptian law also stipulates only Egyptians can act as importers. Once again, if it is applicable to a project, the Investment Law 8 of 1997 could help since it provides for expedited approval on a duty-free basis for all imported inputs to a foreign investment.

Prospects for Franchising

Egypt has an incentive plan for foreign investment in its law 8 of 1997. As a result, Egypt has been able to attract very significant investments in manufacturing, particularly from the U.S. and E.U., but its laws still reflect Egypt's self-identification as a social democracy rather than a liberal economy. Egypt has great vestiges of its protectionist and centralized planning days in the complexity and perhaps over-regulation of matters such as import and labour. Egypt's decision to liberalize seems to be counteracted by resurgences in perhaps its older thinking, demonstrated in its new technology law. The magnets of its urbanized and populous markets, and increasing stability and prosperity, have all played a role to open up Franchising but these advantages are severely mitigated by continuing legal and regulatory uncertainties.

Conclusions

Stability

The most important factor for the growth of Franchising in Africa is political and economic stability. For foreign Franchisors, the greatest disincentive to investment is economic, the danger of devaluation of currency. A devaluation can increase the price of imported inputs and, hence, affect local competitiveness, while it erodes the value of a Franchisor's capital investments. It can also hinder local partners/Franchisees from fulfilling payments against ongoing royalties and fees. To state this disincentive in a legal and regulatory fashion, the Franchisor's greatest barrier to entry in a market is uncertainty over payment, and the enforcement of non-payment, of ongoing fees by the master Franchisee or the Franchisee. This barrier, perceived from the potential local partner, may appear as unfeasibly high initial fees.

Definition

Business Format Franchising, as a concept, requires a clear legal definition in Africa, one that explains how the whole is more complete than the parts. In industrialized countries, Franchising has carved its own niche, apart from competition laws and securities laws. With respect to these, an understanding has evolved that 'good' Franchising is neither monopolistic, since it relies upon scale efficiencies, nor is it speculative, since investors are largely responsible for their own success.

Franchising, as a multi-unit business, employs scale efficiencies by means of a legal and regulatory system that allows it to exercise potentially strict discipline upon Franchisees. The Franchisor-Franchisee relationship can be, depending on individual Franchisor organization cultures, highly coercive. The Franchisor, ultimately, must guarantee the quality of the end product. As a result, Franchising employs contractual terms that could be interpreted as bad business practices. Clauses requiring exclusive dealings, such as requirements upon the Franchisees to purchase supplies only from the Franchisor or named suppliers, could be misinterpreted as monopolistic practices, and be challenged as a restraint to trade. Without a clear understanding of how it works, Franchising remains in danger of the legal and regulatory environment interpreting it from the context of older business models. And since Franchising is a creature of contract, it is more fragile than traditional single-unit businesses. The legal and regulatory environment is its 4^{th} wall.

Judiciary and Enforcement

Franchising relies on a complex contract to a greater extent than other business models. But Franchising is, in essence, about a relationship between a Franchisor and Franchisees. A court is instrumental in keeping this relationship in order, by interpreting this contract. A police force is necessary to, on occasion, take quick action in order to preserve property. While South Africa's courts are functional, and Morocco's are not far from this goal, in both Egypt and Cote d'Ivoire, the courts would act as liability and may significantly increase risks to an investor. These two countries also have lack of reliable enforcement mechanisms, further jeopardizing a Franchisor's ability to control its system.

Recommendations

Stability and Rule of Law

This may be a given but it still needs to be stressed. A business climate with certainty of conditions and predictability to its legal and regulatory regime is a priority for encouraging Franchising. Stable and transparent institutions, governed by rule of law, are needed in banking, the judiciary, and the police and enforcement services. Judiciaries that are efficient and impartial significantly reduce business risk and encourage investment. Too often were heard complaints of length of litigation and biased or ill-educated judges.

Transparent Banking

Good management of currency to maintain its stability is the bedrock to attracting Franchising. But banking must also be efficient and market-oriented to supply credit and facilitate foreign exchange transactions. Additionally, banks need to be able to provide credit directly and commercially, not through subsidized lending (e.g., social fund). The guarantee of convertibility to Franchisor could also have very positive results.

Enforcement of Laws

Enforcement of laws is critical to promote investment from abroad, especially given the added vulnerability of a non-domestic party.

Promotion

The benefits of Franchising need to be brought to the attention of all relevant parties. South Africa has achieved this end by means of a Franchise Association and by government support for the Franchising sector. An organization such as an association can serve the many functions of education for entrepreneurs, both potential Franchisors and Franchisees, and lawyers, for the general public, and as an advocate for Franchising at the legislative and executive levels. Both foreign and domestic Franchising could be promoted. With a legal and regulatory environment made aware of and supportive to, Franchising, the risks to pioneers will be reduced. These early investors in turn will establish a working understanding of the concept through the marketplace. With time, as in the case of South Africa, the Franchising sector will become its own market force and increasingly, negotiate its own relationship with the legal and regulatory systems of African Countries.

Regulation

The creation of regulation to provide some ground rules to Franchising was recommended by all 21 lawyers. But legislation needs to be framed from the point of view of encouraging Franchising. Typically, Franchising legislation comes in two varieties. The most common kind is disclosure requirements upon the Franchisor. This could be termed, pre-contract regulation. The other kind is what is termed “relationship management” legislation. This kind promotes fairness and reduces economic risk to all parties by specifying norms by which the relationship can be guided. Since good relationships characterize the best franchises, this legislation should be conceived to promote the establishment of such franchises. Some minimum amount of disclosure about earnings and costs could also be required of Franchisors. But beyond this minimum, legislation would harm the entry of foreign Franchisors and inhibit local ones.

Although disclosure type legislation predominates in North America, it is thought to have limited benefit in the African context due to the lesser sophistication of the average investor. A disclosure type of document can be more dangerous to the Franchisee who does not properly understand its implications, and it can act to absolve the Franchisor of continued responsibility. Extensive disclosure obligations, on the other hand, could be beneficial if they emanate from voluntary code applied to members of a Franchisor organization such as South Africa’s, FASA.

Major Foreign Franchisors Need Encouragement

Countries should provide incentives to major Franchisors who have a record of using best practices. These should be targeted and encouraged to make a direct investment through local establishment or through joint ventures with local parties. Such Franchisors would help to establish their best practices and thus create positive norms for the industry.

Other Recommendations

1. Egypt should change its technology transfer law in its new commercial code.

2. Educational institutions/ government training programs should be funded to disseminate Franchising concepts to encourage current and future entrepreneurs.

6 POSSIBLE ROLES, STRATEGIES AND INTERVENTIONS OF DONORS, GOVERNMENTS, AND THE PRIVATE SECTOR IN FRANCHISE DEVELOPMENT

6.1. Overview

In order to optimize the conditions under which Franchising may flourish, donors, various levels of government and the private sector all have vital roles to play. These roles call for specific strategies and interventions.

6.2. Donors

The international perspective of donor organizations indicates donors are in the best position to co-ordinate international efforts to:

a) Develop a universally accepted Codex of Franchise Terms and Definitions in order to facilitate a global understanding (or "Common Language") of Franchising Principles and Practices.
b) Facilitate and support the periodic measurement of the development impact of Franchising development under different political-economic environments globally (in effect, "Benchmarking" on a global scale)
c) Support international exchange programs of government personnel, academics, financial and professional members (e.g., accountants and lawyers) from emerging franchised economies to mature franchised economies and vice versa to stimulate the exchange of knowledge of Franchising "best practices".

6.3. Governments

For the purposes of this analysis, governments are assumed to operate at the national level or the regional/municipal level. We are assuming for simplicity sake that a middle tier or state/provincial level does not exist.

National Governments

National Governments are assumed to be responsible for interaction with the international community and the management of intra-regional resources within their own countries. Generally, they are therefore best suited to facilitate the following:

1) Facilitate and support the periodic collection of data relating to franchising activities.

2) Support international exchange programs of government personnel, academics, financial and professional members.
3) Ensure that the legislative and judiciary environment provides fair and adequate protection for Franchisors and Franchisees operating in their country.
4) Develop an investment promotion database specifically designed for International Franchisors who may be considering expansion into the country. This database may contain such information as, inter alia, demographics, urban/rural mix, business start-ups and failures, restrictions on imports/exports and currency exchange, health and hygiene conditions, specifications and reliability of utilities, labour force characteristics, number and type of Franchise Systems currently operating in the country, etc. This would facilitate a more timely and efficient evaluation of a given Franchise System's growth potential in the country.
5) Create a task force to assist incoming international Franchisors on missions (in coordination with local Franchise Association) and at start up with issues such as permits, contacts, regulations, customs, etc. The task force could be based at the Investment Promotion Agency (IPA) of the country.

Regional / Municipal Level

Develop and implement standards and compliance systems with regards to health, hygiene and safety conditions.

Develop and implement standards and compliance systems with regards to utilities (light, heat and power).

Develop and implement standards and compliance systems with regards to building codes.

6.4. Financial Sector

Identified by almost all Franchisors interviewed as the most significant constraint to growth. Optimized financing strategies may also be used to promote, encourage and reward those Franchisors that consistently implement Franchising "best practices" *and* have a proven and continuing track record of operational and financial success.

This presumed sub-set of Franchisors from the total number of Franchisors in existence introduces the notion of identifying and segregating "Franchise Best Practitioners" as "Qualified" for potential financing by lending and investment agencies.

Optimized financing strategies would conceptually provide financing under significantly more favourable terms and with greater access than would otherwise be available through conventional lending practices.

These Optimized Financing Strategies may be justified for Qualified Franchise Systems on the basis that Franchise Best Practitioners have demonstrated a lower credit risk overall.

Administration

It would appear that the administration and management of any Optimized Financing Strategies could be handled most efficiently through retail commercial banking institutions. Retail commercial banking institutions are assumed to have the infrastructure and systems necessary to disseminate and support the programs.

Optimized Financing Programs

The category of loans and financing programs (collectively referred to as "Optimized Financing Programs") that may be directly or indirectly supported by the development finance institutions (DFIs) might include all or some of the following:

Asset Based Loan Guarantee Programs

Loan guarantee provided by DFIs to local commercial lending institutions for a certain fixed percentage of the historical cost of new or used (independently appraised) capital assets. Premium for application and slightly higher interest cost to pay for bad loans.

Cash Flow Financing Programs

Term loan facility underwritten by DFIs to local commercial lending institutions that can be used for intangible assets and working capital purposes. Franchise Fees and other up-front fees levied by the Franchisor must be substantiated on a "cost plus" basis.

Franchisee Internship Programs ("Sweat Equity" Programs)

Similar to a Management Buy Out ("MBO") program whereby managers of corporately owned retail businesses (as opposed to Franchisee-owned franchised businesses) can earn-out an equity investment in a given location through the profits generated by that business. The managers thereby become Franchisees and convert that location into a Franchised business. Hence removing the investment capital constraint from prospective Franchisees and establishing a "**meritocracy**" (the award of franchise rights and a going-concern Franchised business is based on merit). Profits of the business would be held in trust (like a Registered Savings Plan) with a local commercial lending institution.

Equipment Leasing Programs

An equipment-leasing program for Qualified Franchise Systems carrying discounted effective interest rates and amortized over a term equal to the maximum useful life of the underlying asset (or an average expected useful life with a maximum Residual Value). Thereby lowering the breakeven point of the Franchised business during the Initial Start-Up and Maturation of the Franchised business by minimizing the financing cost of acquiring/leasing equipment. The program would be underwritten by the DFIs through local commercial lending institutions or established leasing companies.

Site Leasing Incentive Program

Head Lease/Sub-lease program whereby a dedicated fund is established to enter into Head Lease Arrangements with Qualified Franchise System Franchisees on conventional fixed monthly gross rent terms and sub-lease to the Franchisee on a variable or percentage of sales basis. Hence transforming a Fixed Cost to a Variable Cost, thereby lowering the business' Breakeven Point, Initial Start-Up Operating Losses and Working Capital requirements. Program would be for the first term of the lease to a maximum period of ten years on assumption it takes the usual business one-year to breakeven and three years to mature. Franchised businesses would thereby pay less rent in dollar terms during the initial start up and maturation stage but more rent in dollar terms at maturity, but always at a constant percentage of sales revenue (hence protecting the overall economic model of the Franchised business).

The program could also include leasehold improvements and other items that would normally be covered by Landlord Inducements.

Others

Promotion and enhancement of Franchising by joining, promoting and supporting national franchise associations.

Develop a comprehensive Franchise Package documenting the requirements and needs of the Bank to facilitate diligent Credit Applications from Franchisors and Franchisees. Use Associations as a conduit between parties to ensure that both parties know what to expect from each other.

To ensure that the bankers have an up to date understanding of Franchising, banks interested in Franchising should be members of the Franchise Associations and have their franchise managers attend franchise networking and knowledge building activities.

6.4. Private Sector and Franchise Associations

At an appropriate time, the franchised businesses on the continent could create and join a Pan-African Franchise Association to serve as a resource centre for franchise practitioners and support groups throughout Africa.

This and the national associations should liaison with the banking sector, the ADB, governments and accounting and legal professionals to foster an understanding of Franchising "Best Practices".

The associations should also enforce that members adhere to Code of Ethics, Disclosure Documents, Member Qualification Process and other procedures similar to FASA. An important function of the associations would be to arbitrate disputes between franchisors and franchisees, particularly in those countries where the judicial system is not very efficient. The associations could, in effect, be self-regulatory bodies of the franchise sector.

Finally, the main role of the franchise association is to become the facilitator for international and domestic franchise systems. Among others, it should organize franchise shows and meetings between international Franchisors and master prospects, manage the qualification process of interested Franchisors, organize international franchise missions, and co-ordinate the various seminars on franchising.

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