

International Microfranchising

The International Transactions Clinic's Experience

By David B. Guenther and David W. Koch

The International Transactions Clinic at the University of Michigan Law School is a full-year course in which law students work on live international transactions for clients.¹ The clinic's clients typically operate outside the United States in challenging legal, financial, and physical environments. Many of these clients use microfranchising and other branded network strategies. This article describes the clinic's experience in advising clients engaged in international microfranchising. The first section briefly describes the clinic and its clients. The second section explores why microfranchising appeals to many of our clients and describes some of their operations and strategies. The final section discusses some of the significant lessons learned by the clinic's legal teams.

The International Transactions Clinic

International Transactions Clinic students typically work under the supervision of an experienced international transactional lawyer and faculty member. The clinic's teams help clients obtain or provide grant, debt, and equity financing; structure social enterprises and hybrid company groups; develop microfranchise and other branded networks; transact international sales of goods; implement best corporate governance practices; and draft a variety of related transactional documents—all in coordination with legal counsel in the jurisdictions in which our clients operate. In the 2016–2017 academic year, the clinic's students (12 student attorneys, three advanced student attorneys, and three



LLM student advisors) provided nearly 2,000 hours of pro bono legal services to approximately 20 clients operating in Kenya, Senegal, South Africa, Mauritius, India, Haiti, and other jurisdictions.

The International Transactions Clinic's clients

The International Transactions Clinic's clients pursue a social or environmental mission independent of, or in addition to, profits. Clients also generally desire to scale up and be financially self-sustaining. To maximize impact, scalability is key.² Traditional grant funding does not lend itself to scalability. Scalability ultimately means equity investors, and equity investors, even in the social enterprise space, are likely to require some sustainable level of profit. The clinic's clients are thus part of a broader movement toward market-based approaches to development.³ Microfranchising has been hailed in recent years as one of the most promising of such approaches.⁴

Microfranchising

There is no common definition of microfranchising.⁵ As in traditional franchising, the franchising component means "replication to scale."⁶ Some commentators have distinguished microfranchising by means of the smallness of some aspect of the model—the small

amount of capital required, the low prices of goods or services sold, or operation within base-of-the-pyramid rather than developed markets.⁷ Others have focused on the goals of microfranchising, which are said to be creating enterprise opportunities for the world's poorest people to alleviate poverty.⁸

Worldwide, the number of microfranchise networks is believed to be growing.⁹ Microfranchising today is where microfinance was 10 or 15 years ago.¹⁰ Much of the growth in microfranchising appears to be occurring in countries that do not have franchise sales laws.¹¹

Why microfranchising for social enterprise?

Traditional commercial franchising offers advantages to prospective business owners.¹² Many of these advantages apply to microfranchising in the social enterprise context.

First, local populations may have few assets and little or no access to capital.¹³ Microfranchising offers a low-cost, low-asset model. The microfranchisor may offer franchisees low-level financing, either directly or through a partnership with a microfinance institution, or by supplying goods on credit or consignment.¹⁴ Microfranchisees may be able to avail themselves of the microfranchisor's economies of scale and obtain goods or services for lower prices than they otherwise could.

Second, populations in frontier markets may have access to a limited range of goods and services.¹⁵ Those living in physically remote or inaccessible areas may have little or no electricity, access to reliable transportation, or other technological infrastructure.¹⁶ A microfranchisor may be able to provide access to an established supply chain and a steady source of goods or services.¹⁷ A microfranchise model can also provide low-priced goods and services that are not otherwise available in the local community.¹⁸

Third, populations at the base of the pyramid may have little education or business experience and few established business skills.¹⁹ A microfranchise model provides skills in the form of training, mentorship, and support. Microfranchisees also enter a community of peers with whom to share their experiences and against whom to measure their success.

Finally, in many frontier markets, there may be little or no effective legal framework.²⁰ Microfranchising offers a comparatively simple, low-profile legal model with flexible, short-term contracts and informal enforcement mechanisms (such as revocation of a license) that

fast facts

Student teams at the University of Michigan Law School's International Transactions Clinic work regularly with clients using microfranchise and branded network business models.

Microfranchising offers advantages to social entrepreneurs operating in challenging legal, financial, and physical environments.

Microfranchising models are part of a broader movement toward market-based approaches to development.

In the 2016–2017 academic year, the clinic’s students (12 student attorneys, three advanced student attorneys, and three LLM student advisors) provided nearly 2,000 hours of pro bono legal services to approximately 20 clients operating in Kenya, Senegal, South Africa, Mauritius, India, Haiti, and other jurisdictions.

do not depend on legal literacy or ready access to legal services or local courts.

Microfranchising also offers advantages to social entrepreneurs, who are generally relieved of the risks of owning properties, hiring employees, and being subject to additional taxes in potentially unfamiliar legal terrain. A social enterprise’s most significant asset may be a brand and associated know-how or other intellectual property, which can be effectively leveraged through licensing agreements with microfranchisees. Royalties, franchisee fees, and product sales may be a source of additional, if limited, capital to microfranchisors. And microfranchisees will also be motivated operators with local knowledge and connections as well as political acceptability that might not otherwise be accessible to a franchisor.²¹

Microfranchising initiatives of the International Transactions Clinic’s clients

Farm Shop

Farm Shop is a Kenyan for-profit company with a Kenyan nonprofit affiliate originally organized in 2011.²² Farm Shop founders Madison Ayer and Farouk Jiwa noticed that rural farmers in Kenya lacked access to quality agricultural inputs. Since 2011, Farm Shop has built a branded network of agri-dealer shops in central Kenya. After locating a suitable microfranchisee, Farm Shop helps finance—often in collaboration with a microfinance institution—a remodeling and renovation of the existing shop; provides signage and other branding under the Farm Shop name and logo; and sometimes extends a working capital loan. Farm Shop uses its existing relationships with larger-scale agricultural suppliers to supply microfranchisees directly with high-quality products at prices they could not obtain on their own. And Farm Shop delivers the products to the microfranchisee’s rural shop.²³

Farm Shop franchisees pay a modest initial franchise fee and a variable monthly royalty fee. They have a specified geographic territory and are required to participate in training and report to Farm Shop on various aspects of operations.

Farm Shop reports that its franchisees are generally cash-flow positive within their first few months and many have seen a 500 percent increase in revenues.²⁴ Their smallholder farmer customers, in turn, are often able to dramatically increase the productivity of their farms, providing additional income for school fees, health, and nutrition, contributing to the prosperity and well-being of the entire community. From its small beginnings, Farm Shop created a network of 25 stores by 2014 and approximately 75 stores by 2016, and aims to have 125 stores in operation by 2018.²⁵ Farm Shop itself as franchisor expects to reach a break-even point at 125 shops.²⁶

Jibu

Jibu is a North Carolina low-profit limited liability company organized in 2012.²⁷ Founders Randy and Galen Welsh saw an urgent need to address the lack of affordable clean drinking water in Uganda, Rwanda, and Kenya. To address this need, Jibu created a network of locally owned franchises that provide clean, safe drinking water at an affordable price. Using specialized equipment, Jibu franchisees purify water from whatever existing sources are available.²⁸ Franchisees operate out of well-placed, high-traffic storefront locations in urban and peri-urban areas. Franchisees have onsite water treatment, bottling and sealing, and retail space.

Jibu offers franchisees a turnkey model, providing equipment, training, and tools, including financing; eco-friendly, energy-efficient water filtration equipment; in-store supplies; and marketing, branding, and training.²⁹

Franchisees' prices to customers are kept low enough to be competitive with the cost of boiling water.³⁰ Jibu has also created a supplementary network of microfranchisees who buy water in bulk from Jibu franchisees and resell it in small local storefronts.

At the end of 2016, Jibu had capitalized and equipped nearly 40 locally owned franchises, who in turn had engaged approximately 100 local microfranchises and hired almost 500 employees in East Africa.³¹ Roughly one-third of Jibu's franchisees and 40 percent of the total jobs Jibu has created are filled by women.³² Through its franchise network, Jibu has provided an estimated 13 million gallons of clean water to people in urban and peri-urban areas.³³ Jibu itself as franchisor expects to break even by 2019.³⁴

For its next expansion phase, Jibu is testing a "master franchise" model in Zimbabwe and Tanzania. In this model, rather than hiring a country director, opening its own office, and launching franchises with its own capital, Jibu licenses local entrepreneur-investors to use the Jibu brand and systems to establish franchises. By licensing the replication of Jibu corporate, Jibu is effectively franchising the mothership.

CultiVert

The CultiVert program was developed under the umbrella of the Yaajeende project, a USAID-funded project focused on feeding people in Senegal more nutrient-heavy foods through Nutrition-Led Agriculture (NLA). One of NLA's four pillars of food security is access, which Yaajeende has pursued via a network of individual Community Based Solution Providers (CBSPs) who serve as the primary link between local farmers and input suppliers. CBSPs work to provide local farmers with access to quality seeds and fertilizers, improved tools, and financing and to broker sales of their produce to buyers. For this work, CBSPs receive a commission from both the producer and the supplier.

The CBSP network has grown rapidly, but with uneven quality along the value chain and no plan for long-term financial sustainability. The Yaajeende team identified social franchising as a strategy for tackling these issues while ensuring that the social focus of NLA remains at the forefront. To develop the franchise concept, which they dubbed CultiVert, Yaajeende began working with the International Centre for Social Franchising, a London-based nonprofit consultancy

specializing in replicating successful social solutions to scale. The goals of the franchise model are to professionalize and create brand recognition for the CBSPs and provide a means to redirect the CultiVert program to the private sector when USAID funding for Yaajeende ends.

Lessons learned

Along the way, the International Transactions Clinic has learned important lessons about applying franchise-like business models at or near the base of the pyramid:

- **Product distribution franchises predominate over "business format" franchises.** Product distribution is easier to understand for new, inexperienced entrepreneurs and offers the client greater brand control because it can cut off access to products for franchisees who fail to pay or uphold brand standards.
- **Social franchisors are as concerned as commercial franchisors about protecting their brands.** The vast majority of social franchisors remain dependent on donor and grant money to advance their missions. Greater weight on doing good and less weight on pure financial results raises the stakes for reputational harm.
- **Getting microfranchisees to appreciate brand standards can be a challenge.** Those with little or no experience operating a business tend to focus narrowly on their own operating results and may use methods that are incompatible with the values of the brand.
- **The franchise model is a means, not a goal.** International Transactions Clinic clients have used microfranchising models because they offered a potential solution to scalability limitations, not because the clients wished to be franchisors.
- **Providing traditional franchisor support may not be enough.** International Transactions Clinic clients typically offer the same kinds of training, marketing, and other support as commercial franchisors. But microfranchisees operating at or near the base of the pyramid may need additional social support, such as help with domestic abuse, access to healthcare, and basic transportation.

- **Cultural norms and local practices can offer opportunities to enhance the program.** Ordinary commercial dispute resolution methods in developed countries are often not feasible in the environments where International Transactions Clinic clients operate. Resorting instead to low-cost, locally familiar practices may be a more practical approach. For one client, the student team built into the franchise agreement an opportunity to submit disputes to a nonbinding peer group of franchisees, followed by referral to the village chief. ■



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ENDNOTES

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2. Kistruck, et al, *Microfranchising in Base-of-the-Pyramid Markets*, 35 *Entrepreneurship Theory and Practice* 504, 519 (May 2011).
3. Fairbourne, *Why Microfranchising Is Needed Now*, in Fairbourne, Gibson & Dyer eds, *Microfranchising: Creating Wealth at the Bottom of the Pyramid* (Northampton: Elgar Publishing, 2007), p 3.
4. See, e.g., Beck, Deedler & Miller, *Franchising in Frontier Markets: What's Working, What's Not, and Why*, *Innovations* 156 (Winter 2010); Burand & Koch, *Microfranchising: A Business Approach to Fighting Poverty*, 30 *Franchise L J* 26 (Summer 2010); *Microfranchising in Base-of-the-Pyramid Markets*, p 504; Gibson, *Microfranchising: The Next Step on the Development Ladder*, in *Microfranchising: Creating Wealth*, pp 17–42.
5. See *Microfranchising: A Business Approach*, p 25.
6. *Microfranchising: Creating Wealth*, p 9.
7. See, e.g., *Franchising in Frontier Markets*, p 155; Fairbourne, *Microfranchising: A New Tool for Creating Economic Self-Reliance*, 8 *ESR Rev* 19 (2006); Lehr, *Microfranchising at the Base of the Pyramid* (August 2008), p 4; *Microfranchising in Base-of-the-Pyramid Markets*, p 506.
8. See, e.g., *Microfranchising: A New Tool*, p 19; *Microfranchising: Creating Wealth*, p 2; *Franchising in Frontier Markets*, p 155.
9. *Microfranchising: A Business Approach*, p 26.
10. *Id.*
11. *Id.* at 30.
12. See Lederman, *Franchising and Franchise Law: An Introduction*, 92 *Mich B J* 34–35 (January 2013).
13. *Microfranchising: A Business Approach*, p 26.
14. See *Franchising in Frontier Markets*, pp 157–158; *Microfranchising at the Base of the Pyramid*, p 11.
15. See *Microfranchising: A Business Approach*, p 26; *Microfranchising: A New Tool*, p 21.
16. *Microfranchising: A Business Approach*, p 26.
17. *Microfranchising at the Base of the Pyramid*, p 5.
18. *Microfranchising: A New Tool*, p 21.
19. See *Microfranchising: A Business Approach*, p 26; *Microfranchising at the Base of the Pyramid*, p 5; *Microfranchising: A New Tool*, p 21.
20. *Franchising in Frontier Markets*, p 156; *Microfranchising in Base-of-the-Pyramid Markets*, pp 513–514.
21. See *Microfranchising at the Base of the Pyramid*, p 5.
22. See Farm Shop <<http://farmshop.co.ke/>>.
23. See Farm Shop, *Model* <<http://farmshop.co.ke/model/>>.
24. NextBillion, *Farm Shop Cultivates Growth* (January 12, 2015) <<https://nextbillion.net/farm-shop-cultivates-growth/>>; see also Farm Shop, *Franchisees* <<http://farmshop.co.ke/franchisees/>>.
25. Farm Shop, *Results* <<http://farmshop.co.ke/results/>>.
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27. See Jibu <<http://jibuco.com/corporate-home/>>.
28. Jibu, *FAQ* <<http://jibuco.com/wp-content/uploads/2017/05/Jibu-FAQs-v3.3.pdf>>, p 4.
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33. Tindera, *Meet The 30 Under 30 Social Entrepreneurs Bringing Change In 2017* (January 3, 2017) <<https://www.forbes.com/sites/michelatindera/2017/01/03/meet-the-30-under-30-social-entrepreneurs-bringing-change-to-your-doorstep-in-2017/#7859e44f4607>>.
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