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# An Exploratory study of franchising as a small and medium enterprises development strategy in Kenya

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# AN EXPLORATORY STUDY OF FRANCHISING AS A SMALL AND MEDIUM ENTERPRISES DEVELOPMENT STRATEGY IN KENYA

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**Submitted in Partial Fulfillment of the Requirements for the Degree of Master of Business Administration**

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## DECLARATION

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

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## ABSTRACT

The study provides an exploratory insight into the factors that globally influence the development of franchising but more specifically, the study explores the determinants of successful franchising development among Small and Medium Enterprises both at the global level and in Kenya. The determinants were organized along four (4) key themes: External environmental specific determinants such as political, legal and economic factors and internal environmental specific factors such as motivation, strategic choice and firm level capabilities. Due to the nascent nature of franchising in Kenya among local enterprises, the study adopted a purposive sampling which entailed selecting indigenous SME business owners that had adopted franchising as business expansion strategy as well as key informants that were conversant with franchising. Primary data was collected by means of questionnaires which were both open and close ended with secondary data being gathered by way of reviewing documents and other report on the businesses that were being studied. The data collected was analysed using case study descriptions as an analytic strategy with the 2 cases being cross-synthesized with the aim of trying to match any existing patters between the 2 businesses. The findings of the study suggest that the Kenyan political environment which is closely related to the legal environment does determine the development of franchising and so does the state of the economy in the country. The motivation of the entrepreneur to choose franchising to grow their business as well as the expansion strategy that they use to achieve the same both have a bearing on the success of their enterprise. The study also shows that there are certain capabilities that need to be developed within the firm in order to succeed in franchising. The study recommends that the government improves the legal environment as regards intellectual property protection and commercial disputes resolution mechanisms in order to encourage franchising. At the firm level, business owners are advised to test their business models until they are confident enough of successfully replicating the same through franchising in order to increase the chances of survival.



**Keywords** *Franchising, SME Development, Business Strategy, Economic Policy, Legal Policy*

**TABLE OF CONTENTS**

**DECLARATION** .......... ii

**ABSTRACT** .......... iii

**Table of Contents** .......... iv

**List of Figures** .......... vii

**List of Tables** .......... viii

**ABBREVIATIONS** .......... ix

**ACKNOWLEDGEMENTS** .......... x

**DEDICATION** .......... xi

**CHAPTER 1: INTRODUCTION** .......... 1

1.1. Background of the Study .......... 1

1.2. Statement of the Problem .......... 3

1.3. Research Objectives .......... 4

1.4. Research Questions .......... 4

1.5. Scope of the Study .......... 4

1.6. Significance of the Study .......... 5

1.7. Structure of the Research .......... 5

1.8. Conclusion .......... 6

**CHAPTER 2: LITERATURE REVIEW** .......... 7

2.1. Introduction .......... 7

2.2. The Origin, Definition and Growth of Franchising .......... 7

2.3. Motivation for Franchising .......... 9

2.3.1. The Resource Scarcity Theory .......... 9

2.3.2. The Agency Theory .......... 11

2.4. The Role of Franchising in SME Development .......... 12

2.5. Franchising as a Business Strategy .......... 14

2.5.1. Strategies for Business Expansion and Market Entry .......... 15

2.5.2. Advantages and Disadvantages of Franchising as a Business Strategy .......... 17

2.6. Factors Influencing Franchise Development .......... 19

2.6.1. Environmental Factors Influencing the Development of Franchising .......... 20

2.6.2. Capabilities for Successful Franchising .......... 22

2.7. The Gap .......... 24

2.8. Conceptual Framework .......... 25

2.9. Conclusion ........ 27
**CHAPTER 3: RESEARCH METHODOLOGY** ........ 28
3.1. Introduction ........ 28
3.2. The Research Design ........ 28
3.3. Population and Sampling ........ 29
3.4. Data Collection Methods ........ 30
3.4.1. Key Informant Interviews ........ 30
3.4.2. Documentary Review of the Cases ........ 32
3.5. Data Analysis ........ 33
3.6. Research Quality ........ 34
3.7. Ethical Considerations ........ 34
3.8. Constraints and Limitations ........ 35
2.9. Conclusion ........ 36
**CHAPTER 4: PRESENTATION OF RESEARCH FINDINGS** ........ 37
4.1. Introduction ........ 37
4.2. Case A ........ 37
4.2.1. General Business Information ........ 37
4.2.2. Motivation for Case A to Franchise ........ 41
4.2.3. Franchising Strategies Used by Case A ........ 43
4.2.4. Firm Capabilities Critical for Successful Franchise System Development ........ 44
4.2.5. Legal and Economic Factors Critical for Franchise Development ........ 48
4.2.5.1. Economic Factors ........ 48
4.2.5.2. Legal Factors ........ 50
4.3. Case B ........ 52
4.3.1. General Business Information ........ 52
4.3.2. Motivation for Case B to Franchise ........ 53
4.3.3. Franchising Strategies Used by Case B ........ 56
4.3.4. Firm Capabilities Critical for Successful Franchise System Development ........ 57
4.3.5. Legal and Economic Factors Critical for Franchise Development ........ 61
4.3.5.1. Economic Factors ........ 61
4.3.5.2. Legal Factors ........ 63

4.4. Key Informants ........ 65
4.4.1. Current State of Economic Conditions in Relation to Franchising and Improvements Needed to Promote the Development of Franchising among SMEs in Kenya ........ 65
4.4.2. Current State of Legal Conditions in Relation to Franchising and Improvements Needed to Promote the Development of Franchising among SMEs in Kenya ........ 68
**CHAPTER 5: ANALYSIS AND DISCUSSION OF THE FINDINGS** ........ 71
5.1. Introduction ........ 71
5.2. Environmental Conditions Necessary for the Growth of Franchising ........ 71
5.3. Strategies that SMEs Can Apply for Successful Franchising ........ 77
5.4. Firm Level Capabilities that SMEs Need to Develop for Successful Franchising ........ 79
5.5. Economic and Legal Policy Recommendations for Franchising Development ........ 82
**CHAPTER 6: CONCLUSIONS AND RECOMMENDATIONS** ........ 87
6.1. Introduction ........ 87
6.2. Summary ........ 87
6.3. Conclusions ........ 88
6.4. Recommendations ........ 88
6.5. Recommendations for Further Studies ........ 89
6.6. Limitations of the Study ........ 89
**BIBLIOGRAPHY** ........ 90
**APPENDIX I** ........ 98
**APPENDIX II** ........ 105

## LIST OF FIGURES

Figure 2.1: Conceptual Framework showing the Internal and External Environmental Factors that affect the Development of a Successful Franchise Business....26

Figure 4.1: Growth of Case 'A' Franchise in Terms of the Number of Outlets and Self-reported (unverified) Financial Performance as at April 2013....39

Figure 4.2: Distribution of Case 'Á' Outlets in Terms of Company Owned and Franchised Outlets across Kenya as at April 2013....40

# LIST OF TABLES

Table 4.1: The Growth of Case ‘A’ Franchise in Terms of the Number of Outlets and Self-reported (unverified) Financial Performance as at April 2013.......39

Table 4.2: The Distribution of Case ‘A’ Outlets in Terms of Company Owned and Franchised Outlets across Kenya as at April 2013............................................40

Table 4.3: The Positive and Negative Experiences of Case ‘A’ Entrepreneur in Using Franchising to Expand his Business..............................................................43

Table 4.4: The Positive and Negative Experiences of Case ‘A’ Entrepreneur in Using Direct Franchising Licensing Form...............................................................44

Table 4.5: The Critical Firm Capabilities to Develop for Franchising according to Case ‘A’..........................................................................................46

Table 4.6: The Economic Conditions Critical for Franchising Development according to Case ‘A’..........................................................................................48

Table 4.7: The Legal Conditions Critical for Franchising Development according to Case ‘A’..........................................................................................50

Table 4.8: The Positive and Negative Experiences of Case ‘B’ Entrepreneur in Using Franchising to Expand his Business..............................................................55

Table 4.9: The Critical Firm Capabilities to Develop for Franchising according to Case ‘B’..........................................................................................58

Table 4.10: The Economic Conditions Critical for Franchising Development according to Case ‘A’..........................................................................................61

Table 4.11: The Legal Conditions Critical for Franchising Development according to Case ‘A’..........................................................................................63

Table 4.12: The Policy Improvements Needed in Kenya to Promote Franchising Development according to the Key Informants........................................................67

# ABBREVIATIONS

| | |
|---|---|
| **GDP** | Gross Domestic Product |
| **ICT** | Information and Communications Technology |
| **IP** | Intellectual Property |
| **KBS** | Kenya Bus Service |
| **KEFRA** | Kenya Franchise Association |
| **KenInvest** | Kenya Investment Authority |
| **KFC** | Kentucky Fried Chicken |
| **KI-1** | Key Informant 1 |
| **KI-2** | Key Informant 2 |
| **KI-3** | Key Informant 3 |
| **KI-4** | Key Informant 4 |
| **KIPI** | Kenya Industrial Property Institute |
| **MoT** | Ministry of Trade |
| **MSE** | Micro and Small Enterprises |
| **MSME** | Micro Small and Medium Enterprises |
| **NESC** | National Economic and Social Council |
| **PwC** | PricewaterhouseCoopers |
| **SME** | Small and Medium Enterprise |
| **UK** | United Kingdom |
| **US** | United States |
| **USA** | United States of America |
| **VMS** | Vertical Marketing System |

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# DEDICATION

To my wife Irene, my daughter Ivanna and my late parents Edwin and Anne, you are what defines my past, present and future life.

# CHAPTER 1: INTRODUCTION

## 1.1 Background of the Study

There are two major categories of franchising namely product-trade name and business format franchising (Alon, 2001). The latter which is the focal point of this research, is the most commonly used method of franchising and is popularly adopted by restaurants, personal and business services, rental services, and non-food retailing businesses while the former is commonly used in automobile dealerships, gasoline service stations and soft-drink bottlers arrangements.

According to Fiedler and Wight (2003), franchising can be defined as a "mechanism for replicating a proven business strategy that is based on the concept of minimizing start-up time and costs, and economizing on scarce entrepreneurial and managerial talent" (p. 183). Inma (2005) on the other hand defines a franchise as a long-term and legal business relationship in which the franchisor, who is normally the owner of a product, process, or service permits another party, referred to as the franchisee, to use it in exchange for some sort of payment.

For a franchise to qualify as a business format franchise, the following elements need to be present in the franchise arrangement; the brand, a proven business model or method of operating and a continuing franchisor to franchisee support system (Fulop & Forward, 1997). Business format franchising (hereinafter referred to as franchising) is designed to have the franchisee and in some cases the franchisor himself replicate, in different locations, the entire franchisor's business concept including the marketing strategy and plan, the operating manuals and standards, and quality control systems.

Franchising as a business expansion and new market entry strategy has increasingly gained wider acceptance and adoption especially within the SME sector in most parts of the world and is being increasingly given keen policy and funding attention by governments as they seek to expand economic and employment opportunities for their citizens (Sadi & Henderson, 2011).

According to Sanghavi (1998), one of the strategies that can be adopted in expanding and developing the SME sector is by encouraging entrepreneurs that have proven business models, recognizable brands and good support structures to replicate their businesses by issuing licences to others to run similar businesses in different locations. This enables them to replicate their successful businesses without having to incur the cost of expansion as it is normally borne by the franchisee or licensee while at the same time creating more revenue streams, employment and contributing to the expansion of the economy among other benefits (Hoffman & Preble, 1995).

Franchising as a strategy for business expansion and entry to new markets is yet to be given serious considerations by local enterprises such as SMEs in Kenya going by the negligible number of indigenous franchises in the country and the minimal coverage the topic gets from the media in business news i.e. both print and digital. This is despite the potential that franchising holds in the growth of enterprises and its contribution to the economy. Supportive systems such as a legal framework, capacity building and financing to spur the adoption and growth of the concept especially among SMEs in Kenya are virtually unknown or not well developed hence further limiting its development.

To achieve Vision 2030, policy experts propose under the economic pillar that one of the areas the government needs to focus on is the creation of new businesses which can then further contribute to the economy through tax revenue and job creation (National Economic and Social Council of Kenya, [NESC], 2007). Franchising could play a key role in contributing to the achievement of this goal and should therefore be given the attention that it deserves by policy makers as well as the private sector in Kenya.

Kenya is home to a few international franchises and has a few home based pseudo-franchise businesses. Brands such as Wimpy, Nandos, Steers, Debonair Pizza are all South African franchises that have been operating in Kenya for over 10 years with the exception of Naked Pizza, Subway and Kentucky Fried Chicken (KFC), all US brands that have been in Kenya for less than 3 years. Other examples of brands that fall under the same category are KPMG, Intercontinental Hotel and Citi (Bank).

Several local brands such Kenchic, City Hoppa and Kenya Bus Services (KBS) operate on a franchise-like format although they don't fall under the business format franchising category, the subject of our research. This is because all the three elements namely, the brand, business model and some element of continuous support have to be present for a business to be recognized as business format franchise.

## 1.2 Statement of the Problem

The Small and Medium Enterprise (SME) sector is widely considered globally as not only important but as the bedrock and engine of economic growth in many economies of the world (Ayyagari, Beck, & Demirguc-Kun, 2007; Beck, Demirguc-Kunt, & Levine, 2005). In the Kenyan context, the private sector contributes about 80% to the Gross Domestic Product (GDP) with the SME sector alone estimated to account for over 25% of the GDP with SME businesses cutting across all segments of the local economy such as agriculture, tourism, services, ICT, manufacturing and trade among others (Ministry of State for Planning, National Development and Vision 2030, 2011). It is also estimated that employment within the SME sector grows at an annual rate of over 10%, which is well above the growth rate of the total labour force in Kenya (Gitahi, 2009) with the sector contributing to 80.6% of all the job created in 2011 (Ministry of State for Planning, National Development and Vision 2030, 2011).

According to (Rubin, 1978), franchising has been considered as one of the ways businesses especially SMEs can overcome the challenge of lack of sufficient capital to expand their operations and this therefore presents a great opportunity for expanding the SME sector in Kenya. However, despite Kenya having numerous small businesses that have built strong brands over the years within their target clientele and which have the potential to successfully develop franchising models and thus benefit from franchising their operations, very few have adopted the system as an expansion or a new market entry strategy with majority of businesses choosing to grow organically, a few through acquisition and others opting to maintain small operations due to restrictions of expansion and associated costs. The government has also done very little to create the necessary incentives to promote franchising.

This study seeks to determine the factors that affect the development of franchising in Kenya by looking at both the internal and external environmental determinants from a franchisor's perspective. The purpose is to come up with recommendations for both entrepreneurs and policy makers aimed at reducing the existing barriers and tapping into the available opportunities to make develop franchising among SMEs in Kenya.

## 1.3 Research Objectives

- To determine the environmental conditions necessary for the development of franchising among SMEs in an economy.
- To come up with suitable strategies which SMEs in Kenya can adopt in franchising their brands.
- To determine the capabilities required to develop successful franchise businesses by SMEs in Kenya.
- To recommend suitable legal and economic policies necessary to support the growth of franchising in Kenya.

## 1.4 Research Questions

- 'What are the environmental conditions necessary to support the growth of franchising?'
- 'What strategies can SMEs adopt to develop successful franchises in Kenya?'
- 'What capabilities do SMEs in Kenya need to develop in order to come up with successful franchise businesses?'
- 'What legal and economic policy instruments, should be formulated to promote franchising in Kenya?'

## 1.5 Scope of the Study

The study will apply an exploratory approach and will be conducted using in-depth multiple case study methodology. The study will employ multiple tools such as the use of interviews and documentary reviews to gather relevant qualitative as well as quantitative data and will be conducted between the month of March and April 2013.

It is however important to note that given the methodology being applied, it is not possible to do a statistical generalization and hence we can only offer explanations that may be applicable to other cases or what is referred as analytic generalization. Our aim is to explain the present circumstance on franchising in Kenya and not to generalize to franchising in general.

### 1.6 Significance of the Study

The importance of this study is to contribute to a better understanding of franchising in the Kenyan context. This could form the basis for further studies on franchising in Kenya. The study will also offer businesses, especially SMEs, with business strategies that could inform their expansion strategies if they do consider the franchising route as an expansion and new market entry strategy within Kenya or beyond. This has the potential of contributing to the growth of the economy and creation of much needed jobs.

Lastly, the study will provide policy makers in the government with information on the right legal and economic conditions that can encourage the adoption of franchising by Kenyan businesses as well as the entry of international franchises into Kenya. This will contribute to the growth of the economy, increase investment in various sectors such as retail, food and services and also create job opportunities for Kenyans.

### 1.7 Structure of the Research

This research is broken into six (6) chapters:

Chapter 1 outlines the research objectives and the questions that will be answered as well as the structure of the overall research process.

Chapter 2 of the research thesis presents a review of the relevant literature on business format franchising where key concepts such as franchising theories, franchising strategies and franchising models are distinguished. A conceptual framework is also developed in this chapter.

Chapter 3 describes the research methodology used in the research process. In this chapter the research design, population, sampling and data collection are also examined.

Chapter 4 presents the findings of research process and the data collected in the research process.

Chapter 5 analyses and discusses the findings of the study while relating them to the research questions and the conceptual framework.

Chapter 6 presents the conclusions and recommendations of the findings of the research conducted. The above also summarizes the entire research process.

## 1.8 Conclusion

In this chapter, an introduction, background on franchising, definition of franchising, the problem statement, research objectives and questions as well as the contribution of the research have all been stated. This will then lead the research to the relevant literature review, which is presented in the following chapter.

# CHAPTER 2: LITERATURE REVIEW

## 2.1 Introduction

A review of existing literature related to franchising will be undertaken with a focus on the following main areas; (a) the origin, definition and growth of franchising (b) the theories commonly associated with motivation for franchising, (c) the role that franchising plays in SME development, (d) the different business strategies commonly adopted by franchisors in business expansion and market entry and (e) the firm level and (f) external environmental factors for successful franchise development. The last part i.e. part (f), shall be reviewed from a macro-level perspective using factors that international franchises consider important before they enter a market, as a signal that the target economy is a potential market for franchising or is supportive of the growth of franchising. This review seeks to satisfy and answer the research question 1 as stated in Chapter 1 above.

## 2.2 The Origin, Definition and Growth of Franchising

The term *franchise* according to Dicke (1992) originated from an Old French term meaning to ‘to invest with a priviledge’ or ‘to set free’ and it referred to government grants that were given to private individuals in exchange for some service for instance tax collection on behalf of the government. However, franchising as we know it today, despite its root word and initial application mainly by the government having a French origin, has its extensive use as business model beginning in the USA (Dicke, 1992; Inma, 2005) and only gained international acceptance in the 1960s (Alon & McKee, 1999).

Fulop and Forward (1997) identify 3 distinct stages in the development of franchising in the USA. They indicate the first stage as being the mid-19th century when Singer Sewing Machine Company introduced franchise-like arrangements in the sale of its machines with the second stage taking place in the 1920s-1930s when petrol companies among other businesses introduced similar franchise relationships. The third and greatest development which led to the birth of business format franchising however took place from the lates 1940s and early 1950s.

Over the years, different definitions of franchising have been advanced by academics who have extensively studied this area with a number of debates taking place on the issue of the definition of franchising (Hoy & Stanworth, 2002). For instance, Preble and Hoffman (2006, p.34) define franchising as “a contractual vertical marketing system (VMS), where channel members are joined together by contracts and act as a unified system” whereas Alon (2004) defines it as an organizational form used as a method of transferring a business format or a business model without incurring heavy financial investment.

Despite the different definitions, there however seems to be a convergence on what are the key elements within a franchise arrangement and that is (1) an existing and well established brand, (2) a proven business system or process or method of operation and lastly, a key distinguishing factor of (business format) franchising, (3) a continuing support system between the franchisor and the franchisee (Aliouche & Schlentrich, 2009; Czakon, 2012; Fulop & Forward, 1997; Inma, 2005; Stanworth & Curran, 1999).

According to Sanghavi (1998), no where else in the world has franchising as a business concept been so widely adopted in a number of different industries as in the USA. The Om Sai Ram Centre for Financial Management Research (2006) estimates that there are more than 3,000 franchise companies in the USA operating businesses in over 60 different sectors whereas according to the PwC (2008) report on the economic impact of franchising in the USA between 2001 and 2005, direct economic output of franchising outpaced the US economy as a whole with the sector accounting for about 8% of all US private sector jobs.

The extensive adoption of franchising in the USA, Canada and the UK among other Western Europe countries has however led to saturation of those markets with most franchises looking toward the emerging markets for new growth (Welsh, Alon, & Falbe, 2006; Ni & Alon, 2010). Other factors that are attracting international franchisors to emerging markets are falling trade barriers, increased economic integration creating trade blocks that present huge potential markets, increased homogeneity in consumer tastes and buying trends across the globe (Chan & Justis,

1992) as well as interest from individuals and governments from these markets (Fulop & Forward, 1997) . According to Alon (2004), policy makers in some of these emerging markets have realized the potential that franchising holds in their countries' economic development as informed by the economic contributions the concept has had in the developed markets and have therefore sought for ways to develop and regulate this form of business. According to the World Franchise Council (2013), there are over 40 national and regional franchise associations in the world just to show how the concept has spread beyond the above regions.

## 2.3 Motivation for Franchising

There are a number of reasons proposed as to why businesses choose to use franchising as a business strategy for expansion within domestic markets or for entry into foreign markets. However, the two prominent and competing theories advanced as the key motivation that leads businesses down the franchising route are the resource scarcity theory and agency theory (Aliouche & Schlentrich, 2009; Fulop & Forward, 1997) even though other theories such as signaling theory (founded on the economic contract theory) have been explored in light of franchising, albeit not extensively. According to Alon (2001), the agency and resource scarcity theories are the two mostly used by researchers in examining the concept of franchising ranging from franchise use to franchise failure and lately social venture franchising.

### *2.3.1 The Resource Scarcity Theory*

The resource scarcity theory suggests that the firm adopts franchising as strategy to access scarce resources such as capital and managerial resources (which come with knowledge of local markets) so as to enable it expand its operations more rapidly while at the same transferring the risk from the franchisor to the franchisee (Inma, 2005; Combs & Ketchen, 1999).

For young and small firms that find themselves lacking sufficient resources such as financial and managerial talent to expand rapidly and compete against established firms the theory suggests that they should use franchising as a strategy to scale up their operations (Alon, 2006; Shane, 1996a) by leveraging on existing managerial capacity of the franchisee as well as the financial capital the franchisee brings on board in terms of the investment for setting up the franchise unit, the lumpsum franchisee fee paid at the start of the franchise relationship relationship and the regular royalty rates paid by the franchisee to fund business growth (Rajiv, 1990).

Combs and Ketchen (2003) argue that capital scarcity is the key resource that drives franchising independent of the other resource scarcities. Norton (1995) on the other hand however disputes this position and proposes that all the resources i.e. financial capital, human capital and knowledge of the market or market information are essential for franchise growth. The theory led to franchising being considered as a low risk method for the franchisor in acquiring financial and human capital for business expansion (Inma, 2005).

The resource scarcity theory has however had its validity questioned by many scholars despite its contribution to the franchising theory (Inma, 2005). The borne of contention lies with the fact that once scale has been reached, the firm starts to focus on company owned outlets as its strategy for profit maximization hence gradually reducing the number of franchisee owned outlets through acquisition or increased company owned outlets as the firm matures (Lafontaine & Kaufmann, 1994; Combs & Castrogiovanni, 1994). Lafontaine et al point out that increasingly, as majorly franchised businesses begin to reduce their resource constraints, they will tend to prefer expanding through company-owned outlets so as to optimize their operations, relationships and strategies.

Franchising is therefore only seen as a suitable means of easing the barriers to access of resources for young or small firms (Inma, 2005) but has not been able to sufficiently address the position of large firms which had full access to both capital and human resources but still decided to employ franchising as a growth strategy (Lafontaine & Kaufmann, 1994). Clearly, the resource scarcity theory is therefore limited in that sense as its foundation is questioned when we consider the case of large firms using franchising as a business growth strategy despite not lacking in managerial, financial or any other resources used as the basis of arguing for the theory in franchising.

### *2.3.2 The Agency Theory*

The agency theory suggests that firms adopt franchising as business strategy to reduce agency problems which come up as a result of the opportunistic behaviour of their own employees (Inma, 2005; Tiessen & Waterhouse, 1983). Its proponents therefore argue that it could be the underlying motivation behind the prevalent use of franchising as an organizational form (Shane, 1996b; Rubin, 1978). Eisenhardt (1989) proposes that due to the conflicting objectives of the principal and the agent, the high costs involved in monitoring the agent and the difference in the attitude towards risk between the principal and the agent, principals should use monitoring and incentives tied to the agent outputs. Carney and Gedajlovic (1991) therefore put forward franchising as a high powered incentive for the franchisee (the agent) to act in the best interest of franchisor (the principal) since the franchisee is compensated in line with the performance of their unit(s) unlike in a traditional set up where the managers compensation is fixed.

The agency theory according to Alon (2006) also posits that firms prefer going the franchising way since they are unable to efficiently monitor their managers. Frachisors will therefore, according to the agency theory, be more inclined towards the use of franchising as a strategy to bring down their increasing monitoring costs since the franchisee’s effort is self-enforced hence reducing the need for monitoring (Shane, 1996a; Carney & Gedajlovic, 1991). The agency theory unlike the resource scarcity theory is not limited to small firms but is also relevant to large firms due to the incentive structure of a franchise arrangement as argued by Fulop and Forward (1997).

This however does not necessarily mean that the franchisee will always perform as per the expectations of the franchisor and so there is always be the risk of shirking or delivering reduced effort by the franchisee despite the fact that their earning is directly linked to the effort they put into the proper management of the franchise. Inma (2005) argues that it “is likely that the complete understanding of the franchising phenomenon may require an explanation involving more than one theory” (p. 44) based on results derived from a study she carried out in Australia which indicated that the application of a sole theory to franchising gave inconclusive results as to the true motivation of firms going the franchising way. However, on the other hand her findings did not in any way diminish the validity of the agency theory as a key motivation for franchising.

Lafontaine (1992) describes the franchisor-franchisee relationship as a dual principal-agent relationship in the sense that both are dependent on the other for something. This view is supported by Carney et al. (1991), who argue that since the franchisor's income is directly related to the performance of the franchisees'units, the franchisor is motivated to offer all the necessary information, a good support structure as well as to promote the franchise concept hence leading to a symmetrical relationship between the franchisor and franchisee(s) or a strategic partnership as defined by Stanworth and Kaufmann (1996). Czakon (2012) however argues that franchising brings entrepreneurs under a hierarchical governance framework where there is a strong assymetry from a power perspective between a franchisor and the franchisee with the franchisor having power over the network of franchisees.

## 2.4 The Role of Franchising in SME Development

Most of franchises globally fall within the category of SMEs (Northern Lights Franchise Consultants Corp., 2002). The concept of franchising has increasingly been accepted as an important tool in the development of SMEs in many parts of the world and has even been successfully adopted by some national governments in the developing world as a strategy for accelerated economic development, job creation, technology transfer and training in the SME sector (Sanghavi, 1998; Alon, 2004; Hoffman & Preble, 1995; Hoffman & Preble, 2004; Kasselmann, de Beer, & Vermeulen, 2002).

Franchising in a country can develop through the establishment of local brands which are then franchised within and outside the country but it can also develop through the entry of international franchises into the country as is the case more often (Alon, 2004). The author indicates that SME development through international franchising within a developing economy takes place in stages following a lifecycle model. He says that foreign franchisors will choose to enter a new market either through master franchising, joint ventures or even sole ventures especially depending on their size, experience, scope, knowledge of the target market, their capabilities and resources. Eventually, small businesses in the form of franchisees start taking shape in the country and increase as the foreign franchisor establishes more franchise units.

In the end, through a 'demonstration effect', local entrepreneurs learn from the foreign and well established franchisors to appreciate the concepts of trade name, goodwill and loyalty to the corporation and eventually start emulating the same principles in their own businesses hence leading to the rise of indigenous franchises in the country with strong brands and tested business formats (Alon & Banai, 2000; Sanghavi, 2001). These authors state that the indigenous franchises end up competing with the foreign franchises for customers and qualified franchisees and in some cases establish local spheres of control eventually ousting foreign franchises, as is the case of South Africa where local franchise systems account for over 80 percent of all franchises (Toit, 2002).

The African Development Bank (2002, p.3) reports that "international franchisors have been generally observed to serve as a stimulus, rather than an inhibitor to the growth of indigenous franchising in host countries, especially in emerging markets. This indirect transfer of knowledge has often contributed positively to a thriving franchise community in these markets. Alon (2004, p.157) however warns that as much as international franchisors entering a developing market contribute to "higher entrepreneurship and SME development", they could also lead to "output destruction due to replacement of non-franchised businesses" as they replace uncompetitive indigenous SMEs offering the same products and services.

In countries where indigenous franchises have flourished such as in the hospitality industry in India, a number of those entrepreneurs started off as franchisees of international brands and later sold them off before establishing their own indigenious brands according to Chandra (1993). A number of them according to the author have succeded in becoming global hospitality brands using the franchise concept. These examples according to Sanghavi (1998) could offer an opportunity to small businesses in developing economies to learn how to establish strong and internationally competitive brands. He advices that for indigenous SMEs to hold their own and compete with international brands, they need to invest in understanding the franchise concepts including its benefits and demerits, developing a deeper know-how of the local market conditions, investing in adequate managerial and technical know-how and financial capital.

### 2.5 Franchising as a Business Strategy

Competitive strategy according to Porter (1996, p.64), "is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value". He goes on further to suggest that the very essence of strategy is to differ from your rivals by performing activities differently. The African Development Bank (2002) postulates that franchising is a business strategy since it is just like any other business strategy that is designed by a firm to maximize market share and minimize risks for its participants.

Since franchising is by nature an approach for business replication, it therefore is in contrast to what organizational theorists and strategic literature argue for, and that is the need for organizations to differ from their rivals in seeking to develop a competitive advantage over them (Winter & Szulanski, 2001). Winter and Szulanski (2001) argue that replication as a strategy appears to have been neglected by scholars studying organizations or has at best been viewed just as the exploitation of a simple business formula.

According to Czakon (2012, p.6), replication appears as an important means for the replicator ( in this case the franchisor) and those who replicate (in this case the franchisees) since "learning in a network environment reveals to be beneficial both to the central actor, who receives detailed information on relevant business contingencies, and the peripheral actors, who benefit from a standardized knowledge transfer and learning support".

Despite the success of franchising as a business strategy in a number of countries, there is evidence to show that franchising does not necessarily imply success as it is also prone to failures (Bates, 1998; Alon, 2004; Stanworth *et al*, 2004). Infact even in the US, a market where franchising has experienced the most explosive growth, Alon (2004, p.161) writes that "one-third of all franchisors stop franchising within four years of operation and three-fourths of franchisors stop within twelve years". Shane (1996b) even goes further to advice potential frachisees to be wary of franchises that are yet to reach their fourth anniversary with other research showing that it can take upto 5-10 years of exploration and perfecting the business model before a firm can franchise successfully (Dalberg , 2009).

Selecting the wrong franchising option could also lead to control problems by the franchisor which may negatively impact on the relationship (Doherty & Alexander, 2006). Sanghavi (1998) therefore proposes that any entrepreneur considering using the concept as a business expansion or market entry strategy should carefully consider the strategic and organizational implications as well as the business environment before going into franchising. They should also note that franchising is not right for every firm (Lafontaine & Shaw, 1998).

### *2.5.1 Strategies for Business Expansion and Market Entry*

In seeking to replicate their business models firms have traditionally used 3 generic franchising or licencing options to expand their businesses or enter new markets and these are direct franchising, area development and master franchising (Preble & Hoffman, 2006).

In d*irect franchising*, the franchisor establishes each individual franchise and manages the resultant system in the foreign market directly whereas in m*aster franchising, the* franchisor grants the master franchisee the right to sub-franchise the franchise concept to others within an exclusive territory thereby creating a three-level franchise relationship. In a*rea development,* a franchisor grants an area development franchisee exclusive rights to a territory or region and requires the franchisee to open and own a specified number of outlets in that region according to a detailed development schedule (Petersen & Welch, 2000; Mendelsohn, 1992). The key difference between master and area franchising is that the former allows for sub-franchising whereas the latter does not (Doherty & Alexander, 2006).

The above options, although defined from the perspective of an international franchising or a franchisor entering a foreign market, the licensing arrangements can also be used within the same country by indigenous franchisors according to Northern Lights Franchise Consultants Corp. (2002). The indigenous franchisors could either decide to only establish company-owned franchise units within their host countries, grant rights to indigenous franchisees within their host countries to establish franchise single units or multi-units in defined locations or geographic area.

However, Preble and Hoffman (2006) propose that for franchisors to be successful, they have to go beyond the 3 generic strategies by suggesting that they also consider using the first-mover, platform or conversion strategies when entering new markets. They suggest that a franchisor should evaluate the foreign market conditions and then determine which of the 3 strategic approaches are most appropriate and how they can be linked with the generic options so as to come up with the best combination strategy to enter the market. They argue that the 3 generic licensing options are at best licensing forms but do not address the strategy formulation question of which market, how and when to enter.

Using the first-mover or early-mover strategy, the franchisor should consider the timing of market entry as it is paramount in determining the long-run strategic performance of the firm. On the other hand, they propose that for the franchises that want to enter very attractive but difficult markets and don't yet have the relevant skills and know-how on how to run a business in such markets, they should use the platform strategy in identifying a similar but more business-friendly market within the same region as their target market. They should then set up in this beachhead market so as to learn and develop the capabilities and skills necessary to enter into the intended market. Their last proposal is similar to what they call reverse franchising where a franchisor uses a conversion strategy to take over independent businesses, chains and franchisees from other franchises and converts them into own franchisees.

However, the above strategies should be used in light of the similarity or dissimilarity of the host market to the home country and the host country's level of development. The strategic approaches should be combined with direct franchising or area development in similar and well developed markets according to Preble and Hoffman (2006). On the other hand master franchising should be used when entering dissimilar and developing markets by international franchisors as it is a low cost and low involvement strategy since the master franchisor in the host country is left with the responsibility of setting up the franchise network as well as collecting fees and royalties (Alon & McKee, 1999; Preble & Hoffman, 2006; Dalberg , 2009).

The above argument is supported by Gupta and Govindarajan (2000) who say that franchisors need to be strategic in their approach to new market entry so as to develop competitive strategies that can then be linked to the 3 generic options of licensing. In other words, before a franchisor decides what option to use for licensing in the new market they want to enter, they must first develop a strategy on how to gain competitive advantage once in the new market.

### *2.5.2 Advantages and Disadvantages of Franchising as a Business Strategy*

Franchising represents a combined alliance (Hoffman & Preble, 2003) where the relationship depends on franchisor and the franchisee cooperating with each other for it to succeed (Shane & Hoy, 1996). This organizational form offers numerous benefits to both the franchisor and the franchisee which makes it have a competitive advantage over independently formed and operated businesses (Sanghavi, 1998) and there is empirical evidence to show that franchises create more value than their non-franchised competitors according to studies carried out in the USA (Aliouche & Schlentrich, 2009).

Franchising firms reduce agency problems compared to firms that choose to grow on their own; they raise low risk or cheaper capital from the franchisees (Aliouche & Schlentrich, 2009; Alon, 2006; Shane, 1996a; Carney & Gedajlovic, 1991). They achieve rapid market penetration at a much lower cost compared to developing their own distribution channels (Czakon, 2009) which contributes to gaining and sustaining competitive advantage; they get access to motivated and skilled indigenous workforce and managers who have better local market knowledge while at same time reducing monitoring and control costs (Fladmoe-Lindquist & Jacque, 1995).

On the other hand entrepreneurs get an opportunity to enter the world of business as franchisees at less cost with a standardized business system, proven operating methods, product or service and a brand name that comes with goodwill (Fladmoe-Lindquist & Jacque, 1995; Sadi & Henderson, 2011) and get to own a business that has a higher rate of survival than independent ventures (Russell, 1997; Brown, 1988) while remaining legally distinct from the franchisor (Fulop & Forward, 1997; Czakon, 2009) .

Franchisees also get access to cheaper goods and service through the franchise supply chain (Justis & Judd, 2004) and receive regular business advice and management support from the franchisor on important areas such as marketing, purchasing, location selection, operating procedures and technological support (Hoffman & Preble, 1991) The network of franchisor and franchisees also yields advantages from “increased market power, access to resources, learning and efficient coordination” according to Czakon (2012, p.5)

There are however some demerits to franchising from both the franchisor and franchisee perspective. In general, under hierarchical governance such as in a franchising network, Doherty and Quinn (1999) argue that innovation, flexibility and proactive behaviour are not easy to generate than in separate firms with Czakon (2012) adding that under some conditions, hierarchical coordination may become costly to the franchisor just as in the case of market coordination that diminishing some of the benefits the franchisor gains by franchising. For innovation to take place, the franchisors need to delicately balance between standardization and leaving room for adaptation to local conditions by franchisees (Cox & Mason, 2007) but they should be wary of letting too much adaptation as it could lead to loss of corporate identity and brand equity (Dant & Gundlach, 1999).

Sanghavi (1998) lists friction due to lack of proper communication between the parties as a cause of many problems but advices that this can be tackled by close attention to the nature and spirit of the franchise agreement. Some of the potential risks that a franchisor may face are challenges with payment of royalties by franchisees, repatriation of fees and royalties due to capital controls in foreign countries, protecting copyright and intellectual property and policing quality standards (Welsh, Alon, & Falbe, 2006 ).

Despite being legally independent from the franchisor, the franchisee still lacks the level of autonomy enjoyed by the independent small business person (Rubin, 1978; Cox & Mason, 2007). He argues that the franchisor and the franchisee are only legally and not economically distinct. Fulop and Forward (1997) on the other hand argue from studies conducted on the issue of autonomy of franchisees, that results have shown that franchisees generally dont harbour the desire for autonomy as they infact chose the franchise option due to the prospect of working under an inter-reliant environment under the umbrella of a large organization.

The interdependence within the network of franchisees and the actions of one franchisee could however have an impact on how customers view the brand and all the outlets associated with the brand in general. Michael (2000) suggests that customers will tend to transfer goodwill from one outlet to another if they are operating under the same brand name. This means that the converse could also apply whereby a negative perception about one outlet affects another franchisee operating under the same trademark.

## 2.6 Factors Influencing Franchising Development

As the markets in the US, Canada, Britain and Australia countries have become saturated (Welsh, Alon, & Falbe, 2006; Ni & Alon, 2010; Welch, 1990; Eroglu, 1992) and profits started to decline due to increased domestic and international competition (Welch, 1993), international franchises have developed a keen interest in the emerging and developing economies as potential markets for business expansion with a number of the firms using the franchising route as a market entry strategy into some of theses markets (Quinn & Alexander, 2002; Quinn & Doherty, 2000). Some of these markets are not only less developed compared to the country of origin of the franchisors but the are also culturally dissimilar and politically unstable according to Welch (1993).

Though not much research is available on this topic, there is a growing interest by researchers on the topic of international franchising (Ni & Alon, 2010), with academics undertaking studies on different aspects ranging from motivation, company experiences, power and control (Quinn & Alexander, 2002; Quinn & Doherty, 2000) to strategic and environmental factors impacting on the international franchises in the emerging and developing economies (Alon, 2001; Alon & Banai, 2000; Ni & Alon, 2010; Preble & Hoffman, 2006; Sanghavi, 1998; Shane, 1996a).

### *2.6.1 Environmental Factors Influencing the Development of Franchising*

According to Ni and Alon (2010) scholars have focused their inquiry of the internationalization process in franchising on two major streams of research, and that is the environmental determinants or country specific factors and the organizational determinants or firm level factors that influence it. The authors explain that the former stream of research which has a macro-level focus has been key in explaining why franchisors prefer to enter certain markets as well as why some countries receive higher levels of franchising investment than others.

According to Eroglu (1992), international franchisors positively relate favourability of the external environment of a country to potential benefits. This according to Alon and McKee (1999) implies that the more an international franchisor considers the political, economic, demographic and cultural factors of a country to be stable, the more the likelihood of expansion by the franchisor into that country.

Economic factors considered as important are such as macroeconomic stability and level of infrasctructural development (Sanghavi, 1998), high or increasing level of individual income (Yavas, 1989), level of development in the ICT sector (Fladmoe-Lindquist, 1996; Sadi & Henderson, 2011), amount of investable assets; (Preble & Hoffman, 2006), ease of entrepreneurship and access to finance (Dalberg , 2009; Hoffman & Preble, 2004; Sadi & Henderson, 2011), sufficient demand or market for intended goods or services (Alon & McKee, 1999; Sanghavi, 1998), positive economic growth and the level of urbanization (Arthur Andersen; 1996) as well as the structure of the economy with liberalized economies being a preference (Alon & McKee, 1999; Hoffman & Preble, 2004).

Demographic factors noted as important for international franchisors are such as a high rate of affinity to entrepreneurship (Michael, 2003), growing or sizeable middle-class and a growing population (Arthur, 1996) including a sizeable youth population (Alon, 2004); women participation in labour markets which presents an opportunity for a market for fast food restaurants among other services needed to meet the needs of working mothers are also viewed positively (Yavas, 1989; The African Development Bank, 2002); potential pool of businesspersons and openness to foreign goods and services (Preble & Hoffman, 2006); reasonable levels of education ensuring a good supply of qualified local labour force (Sadi & Henderson, 2011) as well as enhancing the diffussion of knowledge on franchising which supports its adoption (African Development Bank, [AFDB], 2002).

Difference in language and culture was also viewed as a key derterminant in choosing to introduce a franchise system in a market (Eroglu, 1992). Culture is considered important as it impacts critical factors such as nature of contracts, operations, communication, human resources practices, and the format of the franchise (Justis & Judd, 2004); consumption behavior or preferences (Preble & Hoffman, 2006); the level compatibility in business practices (Sanghavi, 1998) and transaction costs (Baena, 2012). According to Fladmoe-Lindquist (1996, p.425), "The transferability of the system becomes a function of cultural distance between the foreign and domestic cultures. The very strength of a franchising format, its standardization, makes its successful replication in foreign markets difficult".

In terms of the political dimension, international franchisors are mostly keen on evaluating the level of the political risk in a country (Alon & McKee, 1999) where they look at factors such as the existence of democratic political systems (Hoffman & Preble, 2004) and political stability (Alon & McKee, 1999), independence and efficiency of the judicial system (African Development Bank, [AFDB], 2002), whether government regulation is business friendly and protects foreign investors, nature of corporate laws, tax structures and labour practises (Hoffman & Preble, 2004; Preble & Hoffman, 2006) and how enforcable the regulations are (Sanghavi, 1998) especially regarding enforcement of contracts and resolution of intellectual property rights disputes (The African Development Bank, 2002; Hoffman & Preble, 2004), the extent to which there is bureaucracy in accessing services from the government (Kostecka, 1988), ownership restricitions (Justis & Judd, 2004) and import restricitions such as tariff barriers to input components (Justis & Judd, 2004; Sanghavi, 1998), level of corruption and foreign exchange controls (Alon & McKee, 1999; Baena, 2012; Sashi & Karuppur, 2002) as well as the level of support to SME development by the government (Fulop & Forward, 1997). The existence of self regulation through a franchise association is also considered a good pointer to a friendly environment for franchising, especially if self-regulation is effective (Sotos & Hall, 2007).

### *2.6.2 Capabilities for Successful Franchising*

Winter & Szulanski (2001, p. 731) suggest that "replicators [ franchisors] create value by discovering and refining a business model, by choosing the necessary components to replicate that model in suitable geographical locations, by developing capabilities to routinize knowledge transfer, and by maintaining the model in operation once it has been replicated". Floyd and Fenwick (1999) postulate that franchise systems go through a 4-stage development process before developing capabilities for international expansions i.e. concept development, business development, setting up of the initial company-owned franchise units and lastly franchise expansion by recruiting franchisees.

To support this view, Stanworth et al (2004) and Kasselmann et al (2002) suggest that once an entrepreneur comes up with an idea for a franchise, they need to set up a pilot where they develop and test with relevant modifications to their product or service, marketing strategies, staffing procedures and pricing policies among other factors. Similar to Floyd and Fenwick (1999), the above authors add that the franchisor should set up additional outlets in other locations so as to test the replicability of the format using different staff, customers, premises, supply chains etc until they come up with an easily replicable business concept. Equally, Preble and Hoffman (2006) argue that a franchisor's experience and capabilities are important when considering international expansion while Huszagh, Huszagh, and McIntyre (1992) concluded in their study on core competencies needed to successfully expand internationally that experience and size are important.

Experience, brand name recognition, recruitment and selection skills and franchise relationship management are important capabilities for business expansion and so are monitoring and supervision skills (Shane, 1996a; Levent & Wang, 2006; Floyd & Fenwick, 1999). Fladmoe-Lindquist (1996) adds that beyond the above capabilities which are mainly useful in domestic franchising, franchisors must acquire skills such as distance management, cultural adaptability, host country policy evaluation and exchange rate management to succeed in foreign markets. This knowledge according to Eroglu (1992) can be easily learned and acquired.

Franchisors should develop their  own criteria for franchisee selection (Stanworth *et al*, 2004; Kasselmann *et al*, 2002) while evaluating and refining the selection process with experience (Floyd & Fenwick, 1999). They should gauge their ability to persevere based on previous experiences (Stanworth *et al*, 2004; Sanghavi, 1998), technological know-how and relevant business and management knowledge (Levent & Wang, 2006; Sanghavi, 1998), complemantarity of their skills with those of the franchisor (Stanworth *et al*, 2004; Kasselmann *et al*, 2002), personality trait and entrepreneurial attitude (Kasselmann *et al*, 2002; Sanghavi, 1998), financial capacity, business contacts, well-proven local knowledge and access to prime business sites or locations (Choo, Mazzarol, & Soutar, 2007). It is important to know the entreprenuer's motivation to wanting to become a franchisee, whether lack of complete autonomy is an issue for the potential franchisee (Fulop & Forward, 1997) while keeping in mind that poor partner selection can lead to failure (Levent & Wang, 2006)

The franchisor-franchisee relationship has the tendency to mirror a hierarchical governance structure (Czakon, 2009), hence it is important for the franchisor to ensure a balance between formal and informal forms of control (Jap & Ganesan, 2000; Jones, Hesterly, & Borgatti, 1997; Joshi & Campbell, 2003) while seeking to use non-coercive power and informal social relationships (Fulop & Forward, 1997). This is because the contract, regarded as a major source of power, control and conflict, has been shown to be a fairly weak factor in creating commitment if used as the only form of control (Anderson & Weitz, 1992). Boulay (2010) postulates that the franchise contractual agreement which defines the relationship, the implementation of information systems for monitoring and control and the development of relational norms to enhance common values within the system all play a key role in governing the franchisor-franchisee relationship.

The franchisor should avail pre-engagement training and information sessions (Levent & Wang, 2006) and explain the logic of the franchise partnership, importance of the brand and brand standards (Elango & Fried, 1997) to potential franchisees. Once a franchisee is engaged, a franchisor should put in place operational support mechanisms such as opening of the initial business premise, visits, marketing and advertising as well as strategic franchise management support in the form of franchise manuals, development plans and performance management (Doherty, 2007; Floyd & Fenwick, 1999; Kasselmann, de Beer, & Vermeulen, 2002).

The franchisor should also ensure there's ongoing support (Boulay, 2010; Floyd & Fenwick, 1999 ), provide regular training (Doherty, 2007; Floyd & Fenwick, 1999) and adopt a supportive leadership style while being open to new ideas from franchisees who are a vital a source of innovation (Stanworth *et al*, 2004). Franchisors should also take a proactive role in diffusing tension and resolving any conflicts or problems arising with the franchisee while also putting down measures to minimize the same (Fulop & Forward, 1997; Floyd & Fenwick, 1999).

## 2.7 The Gap

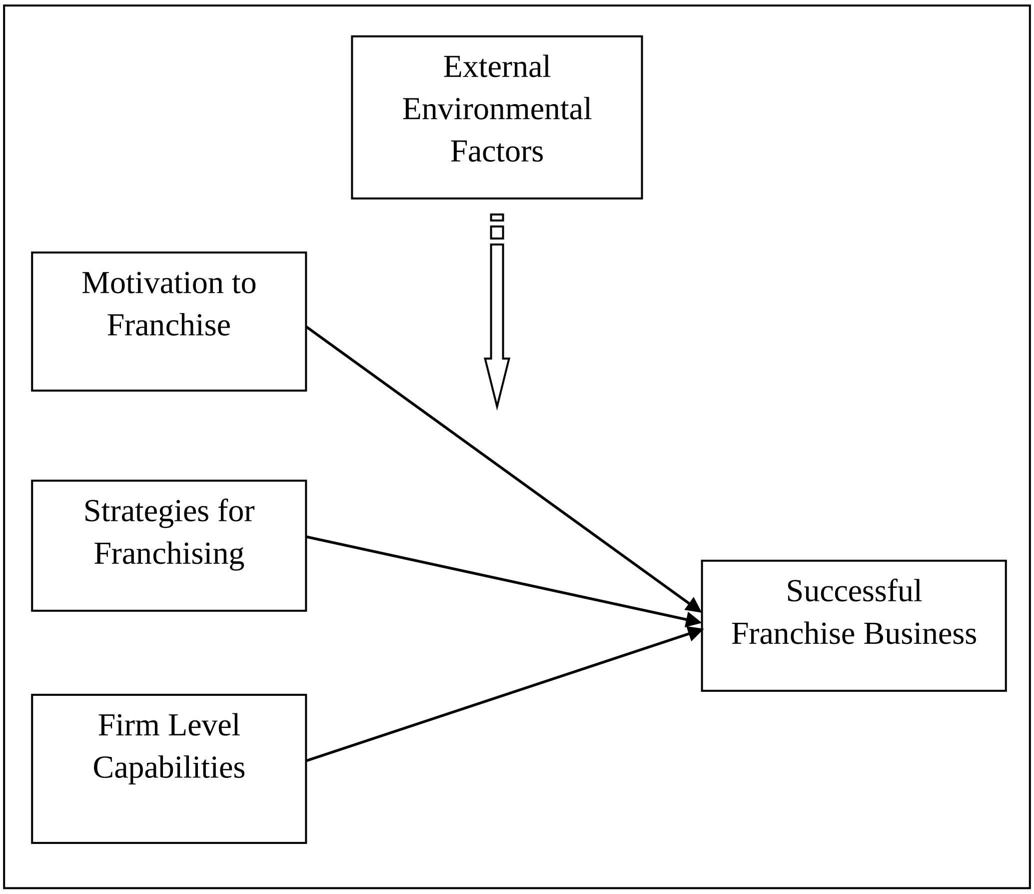
It is noteworthy from the above literature that there has been little research conducted on the state of franchising, its development and the experiences of both domestic and international franchisors in Kenya. To the best of the researcher's knowledge, the studies that have mentioned Kenya have only done so in passing within the context of franchising in Africa and no study has explored franchising from a Kenyan perspective or even the potential that it holds to SME development in the country. There is lucid evidence obtainable from the literature reviewed that franchising has the potential of contributing greatly to the development of the SME sector which can then further lead to job creation, increased government revenue through tax, poverty reduction and overall economic development. It is therefore important to understand the state of franchising in Kenya, the experiences of existing franchises and the nature of the market conditions in relation to franchising.

This study is therefore an attempt to deal with this gap by exploring franchising within the Kenyan context as an SME development strategy. The lessons gathered from the study would lead to a better understanding of franchising in Kenya, the developments so far and the challenges that need to be addressed by entrepreneurs on one hand and the government of Kenya on the other to enable the further development and adoption of the concept.

## 2.8 Conceptual Framework

The conceptual framework as illustrated in Figure 2.1 below has been developed from the literature review and will be used as the guide in the development of variables to be measured as well as the methodology to be used in gathering data for use in the study.

**Figure 2.1: Conceptual Framework Based on Reviewed Literature**




*Source: Stanworth et al (2004); Preble and Hoffman (2006); The African Development Bank (2002); Alon (2004); Winter and Szulanski (2001); Kasselmann et al (2002) and Floyd & Fenwick (1999)*

*The conceptual framework shows the internal and external environmental factors that affect the development of a successful franchise business.*

On the basis of the literature reviewed in section 2.3, 2.4 and 2.5, the study proposes that to develop a successful franchise business, first a franchisor must have a clear motivation as to why they prefer using the route to expand their business or enter new markets and this motivation has to be driven either by the need to minimize agency problems as their business grows or to leverage on other people's resources to grow the business. Secondly, a franchisor must develop a clear strategy through which they want to expand their business or enter new markets and lastly, develop the capabilities required at the firm level to successfully manage and grow a franchise system. In all this, a franchisor must be aware of how external environmental factors affect their motivation, strategies and capabilities and how that impacts their ability to manage and grow their franchises.

## 2.9 Conclusion

This chapter has presented a review of the relevant literature in relation to franchise system development. A conceptual framework to guide the study has also been developed and this shall be used in exploring the status of franchise system development and the experiences of existing franchises in Kenya as well as the potential that it holds for SME development. In concluding, despite the fact that franchises also face challenges just as any other businesses that lead to failure, the literature highlights that the concept holds a lot of potential in accelerating the emergence on small businesses through replication which have a high chance of survival than independent businesses if the franchisor has developed a solid system before franchising. Development of a solid and profitable franchise system is therefore critical for supporting the survival rates of franchisees and promoting the development of SME businesses.

# CHAPTER 3: RESEARCH METHODOLOGY

## 3.1 Introduction

This chapter outlines the research design and methodology to be utilized in the study. According to Yin (2009), a research design can be defined as the logic that connects the data to be collected as well as the conclusions to be drawn to the research questions posed by the researcher. It is therefore the general plan of how one goes about answering the research questions i.e. what questions to study, what data are relevant, what data to collect and how to analyze the results (Saunders, Lewis, & Thornhill, 2009).

## 3.2 The Research Design

The choice of the study strategy by the researcher had pragmatism as the philosophical underpinning with the view that the research questions can provide guidance in deriving acceptable knowledge from both observable phenomena as well as subjective meanings.

A case study according to Yin (2009) is a research method or an empirical inquiry that seeks to investigate a contemporary phenomenon within its real life context. This is done through an indepth study of a single event, group or events and may be descriptive or exploratory. It is especially useful when the boundaries between phenomenon and context are not clearly evident and more so if one wishes to have a clear understanding of the context of research and the processes being carried out (Morris & Wood, 1991).

The study was carried out using an indepth multiple case study approach. The multiple case study approach is important especially when there is a need to relate findings from the different cases as well as the need to generalize from the same findings (Saunders, Lewis, & Thornhill, 2009). However, it is important to note that the type of generalization from findings of case studies can only be what is called analytic generalization by Yin (2009) and not the statistical generalization derived from studies done using surveys (Fowler, 2002) and other research methods. The overall aim will therefore not be to enumerate frequencies as in statistical generalizations but to offer explanations that may be applicable to other cases.

### 3.3 Population and Sampling

To determine the relevance of the selected units of analysis, a specific process was followed. This started with the review of the research questions so as to identify the relevant information to be collected about the units of analysis. This was meant to clarify the questions being sought to be answered and why the chosen units of analysis. Time boundaries to define the beginning and the end of the case were also defined for each of the units of analysis so as to determine the scope of data collection as well as distinguishing data about the phenomenon from the context. The literature review conducted was the basis upon which the conceptual framework was developed and also the refining of the research objectives and questions.

The 3 franchise businesses chosen for the case studies were selected using convenience sampling. The researcher was interested in interviewing the founders of indigenous SMEs using franchising as a business strategy. The firms were all less than 20 years old, with the oldest being 16 years old, the second oldest 8 years old and the youngest one being less than 5 years old. One of the franchisors however opted out of the study leaving only 2 that were eventually interviewed.

The units of analysis within the cases selected were defined as motivation, strategy and firm capabilities. The aim here was to look at these 3 variables in terms of how they individually and collectively impacted on the success of the franchise business with success here being measured in terms of growth of the business. The aim was to understand what motivations led each business to choose franchising as a business growth strategy, what approaches the management put in place to achieve the intended growth and lastly, what the firm considered the key capabilities that it needed to acquire so as to support its growth and enhance performance.

Challenges in implementing the chosen strategies and in acquiring the required firm capabilities, including what brought about the challenges, were also explored. External environmental factors that were out of the firms control were identified and enumerated for each of the cases. The researcher also sought to know whether based on experience, the business owners’ motivation to franchise was vindicated while at the same time seeking to find out what the franchisors considered as positive and negative experiences in implementing their franchising strategies.

## 3.4 Data Collection Methods

Multiple case study approach was selected as the most appropriate for indepth examination of the state of franchising in Kenya. As suggested by Yin (2009), most multiple-case designs are likely to be more robust than single-case designs due to the fact that findings on the topic of study can be related with one another and also provide sufficient evidence for an analytic generalization to be derived from the cases. The evidence from multiple case studies is therefore more compelling than from a single case study.

Yin (2009) also points out that since the case study approach utilizes multiple sources and techniques in the process of gathering evidence, it provides a very useful way of converging the data in a triangulating fashion thus ensuring construct validity. Stake, (1995), and Yin (2009) identify some of the primary sources of evidence for case studies and these include interviews, documents, archival records, physical artefacts, direct observation and participant-observation.

The study was conducted by employing multiple tools to gather relevant qualitative as well as quantitative data. This entailed the use of interviews and documentary review to gather both primary and secondary data. The process took place during the months of March and April 2013 with verbal (informed) consent being obtained before each of the interviews.

### *3.4.1 Key Informant Interviews*

Interviews are some of the most important sources of information for a case study according to Yin (2009) as they provide detailed information with relative ease. He however indicates that there is a great departure of interviews in case study from those conducted in surveys in that they are more guided conversations rather than structured with the researcher being allowed to seek clarity if necessary. Potential weaknesses of interviews are such as response bias; poor recall leading to inaccuracies, inaccurate articulation of questions leading to bias or wrong information among others. Corroborating information from interviews with evidence from other sources is critical in addressing these weaknesses.

Key informants interviews is one of the type of interviews that can be used in gathering case study information and they are qualitative indepth interviews targeted at respondents who are considered to be deeply conversant with the phenomena being studied. According to Yin (2009), key informants not only provide the researcher with great insights into the phenomena being studied but can also be a link to both corroboratory and contrary sources of evidence.

Interview themes for the key informants were developed by the researcher from the study of relevant academic literature and the theories being considered under the study. Interview guides were developed based on the four key themes of (1) motivation, (2) strategy (3) firm capabilities and (4) the external environmental factors identified as influencing franchise development. However, on the last theme, the researcher has limited his scope to only 2 factors i.e. the legal and economic conditions necessary for the development of franchising within an economy. The interview themes were prepared with the aim of guiding the interviews so as to ensure a consistent line of inquiry while at the same time avoiding bias and rigidity.

The researcher developed a list of potential key informants over and above the founders of the 2 franchise systems that were eventually interviewed taking into account the need to have diverse sources of information from different backgrounds that are related to the topic of study and the research questions being posed. This enabled the researcher to get rich data and diverse perspectives from the informants based on how they perceived the phenomena being investigated as a result of their experiences but also the influences of their backgrounds.

The key informants selected for the study were drawn from relevant and senior officials at the Kenya Franchise Association (KEFRA), Kenya Investment Authority (KenInvest), Ministry of Trade (MoT) and the Kenya Industrial Property Institute

(KIPI) as well as a legal expert who is conversant with the phenomena being studied. The interviewees were purposively selected so as to ensure that we got information from individuals who are charged with responsibilities related to our scope of study and in essence giving us relevant data. 1 interviewee was selected from each of the above organizations and sectors hence bringing a total of 5 key informants.

All the interviews were conducted using the face-to-face technique. This technique was used so as to ensure indepth discussions while at the same time giving the researcher the opportunity to probe further responses given by the interviewees. The technique also allowed the researcher to follow on discussions by the interviewees that had not been previously considered but which were deemed useful in helping address the research questions and objectives.

The research settled on note-taking as the primary method for recording interview data. The key challenge with this method however was giving full attention to what the interviewee was saying while at the same time taking down good notes.

#### *3.4.2 Documentary Review of the Cases*

Documentary review is one of the useful ways of collecting data in a case study but the main purpose of the collected information is to corroborate and augment evidence gathered from other sources Yin (2009). He however further cautions against taking documentary evidence as definitive findings. He recommends that the researcher should acknowledge that the information could be biased as it was meant for a specific audience and for a specific purpose and therefore one should be objective by being correctly critical in interpreting the evidence presented by the selected documents.

There is therefore a need to have a systematic approach in reviewing documentary evidence with the recommendation by Yin (2009) being to start before the actual data collection by carrying out internet searches for news articles et al as well as other articles appearing in the mass media. This can produce valuable information that can also inform your actual data collection. Accessing information from local libraries and the company records during the field visit is also another way of searching for relevant documentary evidence. The researcher is however cautioned to only focus, as a first step, on reviewing documents that are central to the topic of inquiry.

A detailed review of documents from the 2 cases was carried out with relevant secondary data being gathered for corroborating and augmenting the evidence from other sources. The information was gathered from such documents as extracts of business plans of the franchises to understand their strategies, samples of franchise agreements between the franchisors and their franchisees, evaluation reports on the franchises and media reports on the franchises. An initial review of readily available documentary evidence was done before the interviews so as to gain a background of the cases being targeted and more so in identifying the potential case informants.

### 3.5 Data Analysis

One of the biggest challenges in the use of the case study approach is arguably the analysis of the case study evidence and this is mainly due to the fact that the techniques used in the same still have not been well defined (Tellis, 1997).

Some critics of the case study approach have gone ahead to recommend making the case study approach more conducive to statistical analysis so as to make the process much easier and more acceptable but this is only possible, according to Tellis (1997), where case studies lend themselves to this type of analysis, which by nature of the case study design is not common. Miles and Huberman (1994) on the other hand suggest the application of analytic techniques such as rearranging the arrays, placing the evidence in a matrix of categories, creating flowcharts or data displays, tabulating the frequency of different events, using means, variances and cross tabulations to examine the relationships between variables, and other such techniques to facilitate analysis.

Yin (2009) recommends that the researcher starts with an analytic strategy which defines “priorities for what to analyze and why” (p. 126). He proposes four strategies for general use. These are relying on theoretical propositions, developing case study descriptions, using both quantitative and qualitative information and lastly, examining rival explanations. Once a researcher has decided on which analytic strategy to use, the use of the five specific techniques for analysing case studies can then be practised. Yin (2009) enumerates the techniques as follows: pattern matching, explanation building, time series analysis, logic models, and cross-case synthesis.

This study utilized case study descriptions as the analytic strategy and a cross-synthesis of the 2 cases with the view of pattern matching. Detailed narrative reports on each firm structured around the research questions were prepared and these provided within-case analysis hence enabling the researcher to understand each case on its own before embarking on cross-case analysis in an attempt to generalize patterns across the cases.

### 3.6 Research Quality

The researcher was keen to ensure that the key research elements of validity, reliability and objectivity were maintained throughout the research process. To ensure construct validity, the researcher utilized multiple sources and techniques in the process of gathering evidence which allowed for triangulation of data and at the same time ensuring that objectivity is maintained at all times. The researcher went beyond the use of multiple sources of evidence and created a case study database while at the same time strived to maintain a chain of evidence so as to increase the reliability of the information gathered in the 3 cases. Cross referencing of documents was also carried out throughout the data collection and analysis process.

### 3.7 Ethical Considerations

All the interviewees selected for this study i.e. both the franchisors and key informants voluntarily agreed to participate in the study hence the interviews were conducted on an informed consent basis. The researcher made a commitment to the study participants to maintain utmost confidentiality with pseudonyms being used to refer to the 3 cases and the individuals selected as part of the study.

### 3.8 Constraints and Limitations

The researcher faced a number challenges while carrying out the study. One of the key constraints was the issue of access to not only information on the different cases but to some interviewees as well. It was not possible to get one an opportunity for an interview with one of the 3 selected cases despite numerous attempts to do so hence the researcher ended up only covering 2 cases instead of the initially planned 3 cases. Despite this limitation, the researcher believes that the 2 cases could still give us an opportunity to relate their findings as well as generalize from the evidence gathered from them. However, the interviews conducted were indepth and hence should be able to provide us with great insights into the cases and the phenomenon being studied.

It was also not possible to access physical financial information from the 2 cases as they were not willing to share the same with the researcher with only one of the firms giving self reported information on financial performance. This limitation means that we are not able to compare financial performance among the cases however, the research is of the opinion that we can infer the overall performance of the 2 firms by looking at their growth in terms of number of franchise outlets i.e. both company owned and franchised outlets, information that is available from documentary evidence gathered by the researcher. The documentary evidence gathered for this research has the limitation that it could be biased but the researcher will be careful to maintain objectivity while reviewing the data therein.

Lastly, it was not possible to get access to one of the key informants who had been targeted to provide information on intellectual property from a policy perspective, with the researcher being directed to the organization's website for any information he needed. However, the researcher managed to get a legal expert in franchising who to a great extent enabled the researcher to get some important information that would have otherwise been provided for by the above organization. The 4 key informants interviewed have ranging expertise on different policy and practise areas such as SME development and finance, franchise development, foreign direct investment, economic development and corporate law. Each of them was asked the same questions which they were meant to answer depending on their area(s) of expertise but answers were not expected from all the key informants on all matters however the key informants were selected in such a way that all the questions would be sufficiently addressed by one or more respondent.

## 3.9 Conclusion

This Chapter has expounded on the research design and methodology that was utilized for the study. The above study used an exploratory approach to studying the phenomenon with indepth interviews and documentary reviews being used to gather the relevant. Limitations of the study have also been highlighted in this Chapter.

# CHAPTER 4: PRESENTATION OF RESEARCH FINDINGS

## 4.1 Introduction

This Chapter presents the findings of the study through data collected using multiple tools to gather both qualitative and quantitative data and this included use of key informant interviews and documentary review of business plans, contract documents, media reports among others relating to the cases studied. The findings have been structured along the major themes in line with the research questions developed by the researcher.

## 4.2 Case A

### *4.2.1 General Business Information*

Case A is a fast food retail business incorporated in Kenya in 2009 and currently has 2 shareholders. It was started as a sole proprietorship but was later incorporated into a private limited liability company with an investor being brought on board as the second shareholder. The researcher interviewed the founding director who is not only the current managing director of the business but is also the only shareholder who is actively involved in managing the business on a day to day basis.

Before starting the business, the founding director had accumulated over 10 years of relevant work and managerial experience with a regional food retail franchise company both in Kenya and in Zimbabwe where he was managing two of their leading brands. This according to him is where he gained a deep understanding of the concept of franchising, operations and supply chain management as well as honed his overall management skills which he finds critical in running his current business.

The business has 3 main products and services that is sells with the lead product being chicken marinated with specially formulated and proprietary sauces and marinades. The other product is pizza, an offering which the interviewee reported was initiated due to demand from clients and lastly the business has lately embarked on supplying other food businesses with speciality sauces and marinades as a new line of business. The business however does not sell the flavours it uses in its franchise outlets to rival business but formulates different flavours for external markets. The formulas or mixes are also only known to the founding director and are produced centrally to ensure that intellectually property is not breached.

The business considers other food retail business such as Steers, Innscor (they run the Chicken Inn, Pizza Inn and Galitos brands), Kenchic and Mc Fries as the main competitors but reckons that the proprietary speciality sauces and marinates that they use to marinate their chicken gives them a competitive advantage over their rivals. They also indicate that consistency in the taste of the flavours and preparation of their meals across their outlets enables them to compete with their rivals, some of who are several times larger in times of size.

The business started to franchise in 2011 but the founder director indicates that his initial intention when he set up the business was not to start franchising too early. He had set in his plans to first of all perfect his business processes and refine his product offering before embarking on aggressive marketing and franchising to entrepreneurs but he succumbed to pressure from his former colleagues at his former place of work who thought that he had come up with an interesting concept and so encouraged him to franchise back then.

The business according to the self reported financial information provided by the founder, as shown in Table 4.1 and Figure 4.1 below, broke even in its 4$^{th}$ year of operations i.e. in 2012 with its gross revenue growing more than 10 times between 2009 and 2012. The founder expects the business to continue on that trajectory as more company owned and franchised outlets are opened across the country over the years. See Table 4.1 and Figure 4.1 and Table 4.2 and Figure 4.2 below for the number of outlets and their types and locations respectively over the years.

The business has signed an agreement with one of the leading oil companies which gives the firm exclusive rights to establish a franchise outlet in each of the petrol stations opened by the oil company across the country. These outlets are then managed by the dealers who have been granted a license by the oil company to operate a petrol station under their brand. The oil company covers the cost of equipment, branding and set up expenses for each of the franchise outlets and then recovers that cost over time by increasing by a certain percentage the dealers' monthly rental fee. The oil company according to the interviewee has plans to open over 100 petrol stations over the next 5 years and the business plans to ride on that to expand its footprint.

This is largely due to the fact that the franchise business not only benefits from the oil company assisting its franchisees to set up their outlets but also allows it to leverage its management information system (MIS) to track franchisees' sales as well as to collect revenue hence greatly reducing the operating and monitoring costs.

| **Year** | **2009** | **2010** | **2011** | **2012** | **2013** |
|---|---|---|---|---|---|
| **Number of Franchise Outlets** | 1 | 3 | 5 | 6 | 7 |
| **Sales** | Kes 5m | Kes 17m | Kes 36m | Kes 56m | Not Available |

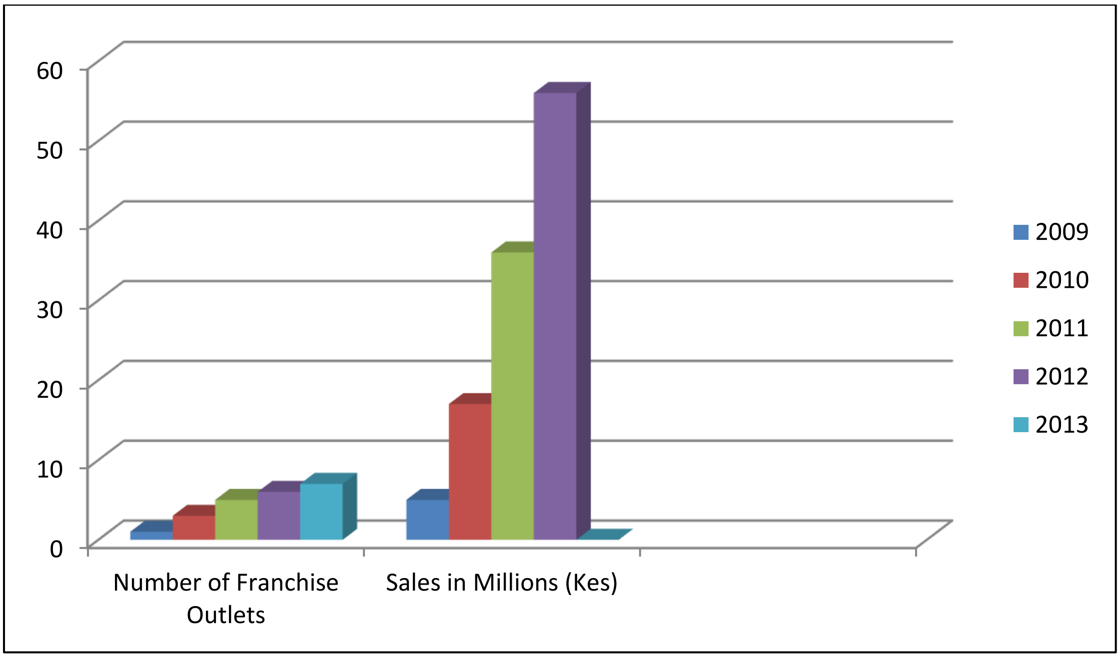



Table 4.1 and Figure 4.1 above show the growth of the company in terms number of outlets and self-reported (unverified) financial performance as at April 2013.

| **Location of Outlet(s)** | **Company Owned Outlet** | **Franchised Outlet** | **Total Number of Outlets** |
|---|---|---|---|
| Nairobi | 1 | 3 | 4 |
| Eldoret | 1 | 0 | 1 |
| Machakos | 0 | 1 | 1 |
| Nakuru | 0 | 1 | 1 |
| Total Number of Outlets | 2 | 5 | 7 |

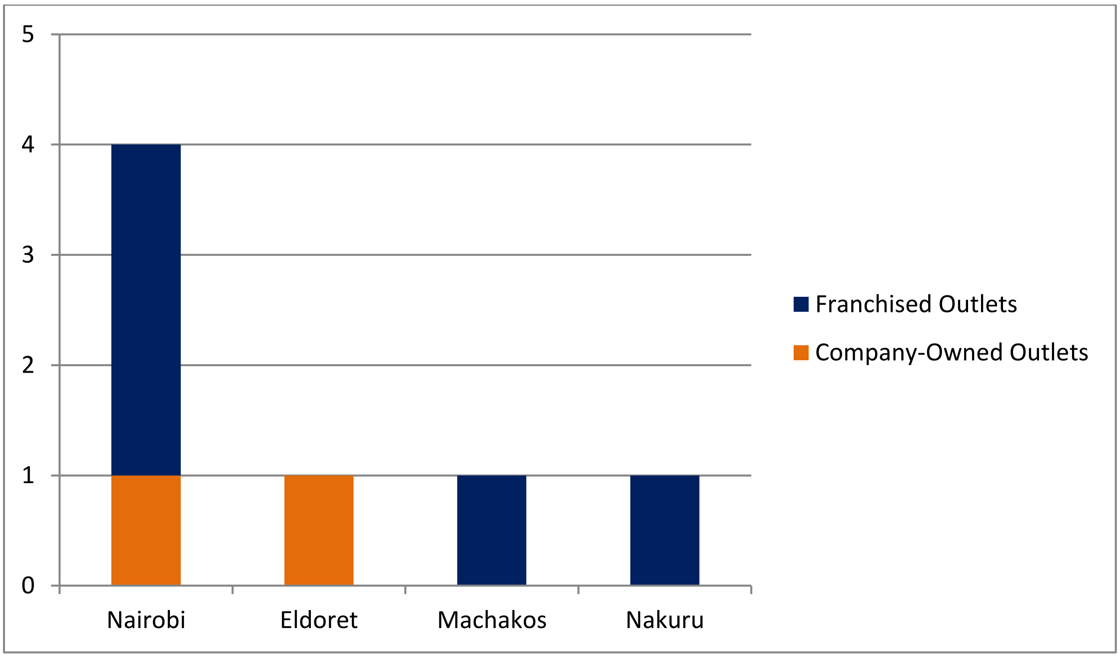



Table 4.2 and Figure 4.2 above show the distribution of outlets in terms of company owned and franchised outlets across Kenya as at April 2013.

In terms of future growth plans, the business plans to increase company-owned outlets to a maximum of 10 outlets while growing franchised outlets to over 100 on the back of the current strategic relationship with the oil company.

The average cost of setting up a standard franchise unit under Case A is Kes 5,000,000 of which equipment takes up 80% of the cost with set-up and branding costs accounting for the remaining 20%. The amount of working needed to start off once the unit has been set up is different per franchisee depending on the level of activity that they want to generate.

### *4.2.2 Motivation for Case A to Franchise*

The agency theory, as illustrated in the literature review advances the argument that franchising helps to align the goals and the risk appetite of the principal (franchisor) with those of the agent (franchisee) by ensuring that the franchisee's compensation is dependent on their effort which in the end reduces the monitoring costs for the franchisor.

The franchisor interviewed for Case A agrees with this position and states that franchising eases the burden of having to run and manage the franchise outlets. He argues that since this is someone else's responsibility, in this case the franchisee's, the franchisor does not have to worry about the day to day management of the business, managing staff and overheads and maintaining compliance with the regulations. The interviewee reports that due to the fact that franchised outlets don't need daily monitoring such as company owned outlets; it is therefore much cheaper to franchise from a monitoring cost perspective as all one needs to do is just to ensure that they provide proper support to the franchisees such as marketing and advertising, negotiating good deals with suppliers and training to ensure that the franchisees grow their businesses.

The resource scarcity theory on the other hand as shown from the literature review proposes that entrepreneurs choose to franchise so as to get access to limited resources such as financial capital, human capital and knowledge of local market conditions in order to grow their businesses. In the case of Case A, the entrepreneur indicates that financial capital and knowledge of local markets are the 2 key resources that inform his decision to franchise and that experience for him is not important. He states that he has successfully integrated inexperienced business people such as retirees into this franchise network due to the fact that he has established a proven method of doing business and provides regular support to his franchisees hence enabling both experienced and inexperienced persons to run their franchise outlets. In terms of financial capital, he states that collection of royalty fees from franchisees is a good way of accessing low cost and low risk capital as well as building up working capital to support the company owned outlets.

The entrepreneur considers the capital low risk as he does not have to carry the burden of operating the franchised outlet, dealing with compliance to local laws and by-laws, insurance costs among others. It is also low cost as he does not make any major investment as in establishing company owned outlets. According to him, having entrepreneurs with local market knowledge taking up franchise outlets also means that he does not have to incur huge costs of managing outlets that are far from Nairobi. He gave the example of the company-owned outlet that is in Eldoret which he reports is proving to be a challenge in terms of cost and time to manage due to the distance from Nairobi, the head office of his business.

On the side of franchisees, the interview reports that they appreciate the concept in the sense that they are getting into a business with a proven business model as well as a strong brand but also reports that they are not willing to pay for the concept forcing the franchisor to use different means to enforce compliance. He also laments that the franchisees, despite appreciating the availability of cheaper supplies through negotiated contract with suppliers by the franchisor, they still want to secure their own suppliers.

The entrepreneur reported his experiences, both positive and negative, of using franchising as shown in Table 4.3 below.

| Positive Experiences | Negative Experiences |
|---|---|
| • Cheaper way of accessing and building up working capital and funds for capital expenditure for company owned outlets.<br>• Access to more knowledge and ideas from franchisees.<br>• Increased brand awareness as the number of outlets grows hence attracting new strategic partners e.g. a South African bakery that is interested in a partnership and another South African business interested in a joint venture with Case A. | • Lack of proper understanding among Kenyans of the franchising concept that makes it difficult to collect fees from franchisees. For instance, it has taken him up to 4 months at times to collect royalties from franchisees and therefore has to do a lot of education before a breakthrough.<br>• Lack of adherence to agreed standards by franchisees e.g. some are introducing unsanctioned products and services without prior approval hence defeating the concept of the arrangement. |

Table 4.3 above shows the positive and negative experiences of Case A entrepreneur in using franchising to expand his business.

### *4.2.3 Franchising Strategies Used by Case A*

Case A entrepreneur has so only used direct franchising to establish all the 7 franchise outlets currently under the business. He considers direct franchising to be the best option for a business at the developing stage since it allows the franchisor to strengthen the brand and support systems before he can start exploring master franchising or area development licensing options. He is however cautious of master franchise arrangements and points out an example of a regional franchise business that had given a master franchise to a business with its own franchise brands but the arrangement collapsed as the franchisor's brands were mixed up with the franchisee's own inconsistent brands leading to dilution of their brand. He states that master franchise license holders may not always adhere to the standards set by the franchisors.

Due to the nature of the market in terms of knowledge on the franchising concept and the growth stage of the business, Case A has not explored the use of the 3 strategies derived from the literature review i.e. early mover advantage, platform strategy and conversion strategy. He considers conversion strategy though from theoretical perspective not to be a favourable strategy due to the capital outlay in the case of converting independent businesses or franchisees of rival firms into company owned outlets but would consider using it if the franchisee would bear the cost of conversion.

Since the entrepreneur has only used direct franchising, he was only able to report the experiences of using that specific licensing form to franchise as shown below in Table 4.4.

| **Positive Experiences** | **Negative Experiences** |
|---|---|
| • Allows direct involvement by franchisor hence easier to make prompt changes if necessary, more so at the development stage of the business.<br>• Allows for greater interaction with consumers which provides insights on their perceptions on the brand. The information gathered is critical in improving the products and services being offered. | • Demand for time is too high in running company owned outlets and supporting franchisees hence there is very little time for other things e.g. exploring other business options and developing new franchise ideas etc. |

Table 4.4 above shows the positive and negative experiences of Case A entrepreneur in using direct franchising licensing form.

### *4.2.4 Firm Capabilities Critical for Successful Franchise System Development*

Firstly, Case A strong believes systems are central to successful franchise and this relates to quality control systems, stock control systems, accounting and point of sale systems. The entrepreneur recommends that for any SME intending to go the franchising way, it is paramount that they ensure that they have put in place robust and functioning systems as they are the backbone of franchising and once in place, it will be much easier to train franchisees to follow and work within the same systems.

Another must before one begins franchising is to ensure that an operating manual has been developed. The manual according to Case A is the bible of franchising as it details how to operate the franchise, how to develop and deliver products and services to customers and all procedures to be followed in running a franchise outlet. The manual generally contains information on products and services to be offered, production procedures, shop layout and floor plan, organogram for shop, operating hours, type of furnishings, list and type of equipment to be purchased, average investment amount, copies of contracts, training manual, simple marketing strategy (generic), branding among others.

Over and above having the above capabilities in place, also highlighted on Table 4.5 below, Case A states that the essence of franchising to licence an already tested and proven business model hence it is critical for an SME intending to franchise to ensure that it develops a refined and solid business model otherwise franchisees may face challenges operating with an unsound business model. He recommends that the business model should be well documented such that anyone anywhere can easily run a similar business with ease. Building a solid business model according to Case A requires that the concerned entrepreneur pilots the business concept in a different location so as to test that the model can actually work and at the same enabling one to determine whether the model is working to generate revenue. This is important before one starts replicating the model through franchising to independent business people.

Piloting in a different context enables the entrepreneur to test the staffing procedures, how the product is prepared, time taken to prepare the product, pricing policies, consistency of taste, ambience of the shop as well as develop a good supply chain for the shop. Different markets according to Case A may demand certain adjustments to size of the outlet, staff numbers among other factors depending on the level of demand for the products, the underlying culture and spending power of people in the target market and he gives an example of the coastal region in Kenya where people prefer eating at home unlike in Nairobi where eating out is more prevalent.

He also emphasises that piloting before replicating through franchising enables the franchisor to understand every aspect of the business and how to trouble shoot in case of any challenges. He also states that this experience is critical as it enables the franchisor to provide practical support to franchisees based on experience. Piloting according the Case A is therefore a critical step that should be taken before the operation manual is prepared.

| **Capabilities Critical for Successful Franchising** | **Tick if Important** | **Give Reason Why Important or Not Important** |
|---|---|---|
| (a) experience | √ | • Enables a franchisor to competently support his franchisees |
| (b) brand name recognition | √ | • Important for the business to stand out in the market as well as enhance top of mid brand awareness |
| (c) franchisee recruitment and selection skills | | • Enables the franchisor to select franchisees with the right fit to the business concept i.e. people who are passionate about the business or brand. |
| (d) problem solving | √ | • Not important in the initial stages but critical once you start franchising. |
| (e) conflict management/resolution | √ | • Important to correct non-adherence or breaches without severing the relationship however advices that major breaches warrant termination of contract. |
| (f) monitoring and supervision skills | √ | • Necessary for checking and enforcing compliance/adherence to standards. Emphasises that monitoring is a key skills needed by any franchisor. |

| | | |
|---|---|---|
| (g) marketing strategy | √ | • Dynamic changes in the market environment require one to be creative in growing the brand through marketing. |
| (h) franchisee support | √ | • Assisting franchisees to source good and affordable supplies, staff recruitment, operating system and marketing is important to enable them grow their businesses. |
| (i) franchisee relationship management | √ | • Important at the initial stage but once the relationship is established, Case A believes that the franchisor more or less dictates the terms. |

Table 4.5 above shows a list of firm capabilities considered, according to the literature review, as critical for the growth of a franchise system and the scoring by Case A on what is critical or not critical and the reasons why it is important/not important.

It is evident from the above table that Case A considers all the listed capabilities as critical for the development of a successful franchise system. Furthermore, Case A believes that based on his experience in franchising, both in employment and in business, that some of the above capabilities would hinder the growth of a franchise business if not developed early enough in the developing stage of a franchise system. He lists experience, brand name recognition and franchisee recruitment and selection skills and site selection (under franchise support) as important capabilities that an SME should develop early enough in order to develop a successful franchise system.

He also indicates that he has faced difficulty in developing quickly capabilities such as franchisee recruitment and selection skills, monitoring and supervision skills, marketing strategy development and franchisee relationship management to match the growth of his business and need for the same skills. However, he states that over time, some of the skills that have enhanced his capacity to manage the growth, relationships and challenges are franchise recruitment and selection skills, conflict management skills, problem solving skills, monitoring and supervision skills and franchise support and that his business has now reached a point where he can now compete with both local and international franchise brands.

He lists his deep understanding of the Kenyan market and better franchise pricing position due to the fact that his equipment and supplies are sourced locally unlike international franchises which source largely from international markets. He however acknowledges that despite the above advantages, many international franchises have years of experience in franchising and are also able to leverage their huge financial resources therefore posing stiff competition and can as well drive indigenous brands out of the market through price wars.

### *4.2.5 Legal and Economic Factors Critical for Franchise Development*

#### *4.2.5.1.1 Economic Factors*

Case A entrepreneur scored in relation to the Kenyan context as shown below on Table 4.6, from a list of the economic conditions generally considered, according to the literature review, as critical for franchising to develop in any economy.

| **Economic Conditions** | **Tick if Important** | **Give Reason Why Important or Not Important** |
|---|---|---|
| (a) Income levels/purchasing power | √ | • Being that fast food, his product offering, is not a necessity (competes with conventional food) but an aspirational product, availability of disposable income among consumers is key in growing demand for his products. He however states that this is only applicable in a stable economy. |

| | | |
|---|---|---|
| (b) market size/demand for products and services | √ | • He indicates that from a food industry perspective and the fact that people need to eat, this may not be as important but further adds that demand is key in any business growth. |
| (c) growth of the ICT sector | √ | • ICT is critical for marketing especially through the social media, enabling online ordering systems, payment systems and integration of systems in all franchise systems to the central system. |
| (d) level of investable assets | √ | • Important for getting franchisees who are able to afford to purchase franchise rights for your system. |
| (e) access to finance | √ | • This is critical for financing growth, new strategies and any other changes in the system that needs funds. |
| (f) economic growth | √ | • Market size and purchasing are determined by the level of economic growth hence this is a very important condition for franchise development. |
| (g) level of urbanization | √ | • Populations living in urban areas have a better appreciation for fast foods hence their growth has the potential to grow franchising businesses in retail fast food. |

Table 4.6 above shows the economic conditions critical for franchising development according to Case A.

Case A according to the scoring on the table above affirms that all the listed conditions are important for franchising to grow within in Kenya just as in any other given economy. In terms of improving the above conditions with the Kenyan context, Case A recommends that the government through the Kenya Investment Authority and Ministry of Industrialization and Trade to set up a department that focuses on the development of the franchising sector. This department should also be tasked with facilitating the setting up of a fund to finance the development and growth of indigenous franchises by providing funds for market development, franchisee finance to acquire franchise outlets among other costs.

#### *4.2.5.1.2 Legal Factors*

The list below in Table 4.7 below shows the legal conditions generally considered, according to the literature review, as critical for franchising to develop in any economy and the scoring by Case A on what is critical or not critical in supporting franchising in Kenya as well as the reasons why it is important/not important.

| **Legal Conditions** | **Tick if Important** | **Give Reason Why Important or Not Important** |
|---|---|---|
| (a) Intellectual property (IP) protection | √ | • IP laws are needed to facilitate registration and protection of trademarks. He recommends that this should be extended to colours used in a brand. |
| (b) nature of corporate laws | √ | • Corporate laws especially touching on franchising are important in guiding the running of businesses. |
| (c) franchise association | √ | • Critical for knowledge |

| | | |
|---|---|---|
| | | sharing among members and more so for lobbying for better conditions for members as well as providing new insights on industry development. |
| (d) tax structures | √ | • Very important to have the right tax structures e.g. considers franchising as any other business hence no need for the current 2% catering levy loaded on their prices/VAT which eventually increases the prices to consumers. |
| (e) nature of labour practices | N/A | • From a franchisor's perspective, this is not relevant as they are not responsible for managing manpower in franchised outlets. However, it may be important for a franchisee. |
| (f) independence and efficiency judicial system | √ | • It is critical that legal disputes between franchisors and franchisees are settled quickly to save on cost and time hence the need for an efficient judicial system. This is also important to avoid status quo and to protect the brand from negative publicity. |
| (g) legal enforcement of contracts | √ | • A franchisor needs to enforce contract agreements with franchisees in case there is a breach and hence the law should provide this foundation. |
| (h) support to SMEs by | √ | • Franchising is a fast way of |

| | | |
|---|---|---|
| governments | | enterprise development due to its concept of offering a strong brand, proven method of doing business and ongoing support and is there a good avenue for rapid economic development and should be supported by the government. |

Table 4.7 above shows the legal conditions critical for franchising development according to Case A.

Apart from labour conditions, Case A lists as important all the other legal conditions above in supporting the development and growth of franchising in Kenya. He highlights a number of areas that the government needs to improve in order for franchising to flouring in the country. One of his concerns is the need to improve the protection of trademarks by adding the possibility to add colours as part of the logo and link that up with the products and services being offered. This he emphasises will enhance the trademarks of franchises and limit the chances of copy cat offering the same products and services to confuse clients by using similar colours and near-similar logos. Secondly, he recommends that the judicial system needs to improve in its delivery of judgements and should be sensitive to the effects on the brand when passing judgements where there is a dispute between a franchisor and franchisee over brand related issues. Thirdly, the government should set a department solely responsible for promoting franchising in Kenya and lastly, eliminate or waive the 2% levy for fast food as they are not in the hotel category and there is no direct benefit that accrues to fast food business from the payment of the 2% catering levy.

## 4.3 Case B

### *4.3.1 General Business Information*

Case B is a limited liability company operating in the hospitality retail sector. The founder had worked in the hospitality industry for many years before setting up the business. He set up the business in 1997 as a prototype for franchising development after which he opened the first unit in 1998. The business operates a restaurant and pub concept and therefore sells food and drinks including alcoholic drinks. He defines his business as a club house but with a much younger demographic and affordable pricing and considers his competition as any other business that provides food and entertainment to clientele from multicultural backgrounds where clients can be comfortable and enjoy themselves regardless of their background.

The business had as at the time of the interview only 1 company-owned outlet in Nairobi however it had grown up to 11 outlets by 2005 before scaling down the operations over time to the current level due to legal disputes with franchisees. Due to this experience, the business only plans to expand by opening only company-owned outlets in Kenya and would only consider franchising outside Kenya but all this is dependent on bringing on board a new investor to fund the growth.

The average cost of setting up a franchise outlet in Case B is at Kes 3,500,000 with the upper limit depending on the size of the outlet, furnishings and equipment that the franchisee wants to put in place. Of this cost, about Kes 1,700,000 is fee for license rights to operate a franchise under the Case B brand.

### 4.3.2 Motivation for Case B to Franchise

Case B entrepreneur indicated that his greatest motivation to go the franchising way was as a result of findings that he had come across while working in the hospitality industry that at least 90% of restaurants started failed in their first 2 years largely due to the owners not having the necessary skills and know how to manage their start up businesses. He also went further to state that the same findings showed that franchising seemed to solve this problem globally due to the fact that the franchisees were getting businesses with strong brands, proven operating method and were getting regular support from franchisors hence increasing their chances of survival.

He indicates that his greatest motivation to set up the franchise business was to demonstrate to Kenyans the potential of franchising as well as to international franchisors that the market was ready for entry. He formed a partnership with one of the leading regional oil companies where he was to set up Case B franchises where the oil company had petrol stations. This partnership, though beneficial in the sense that the oil company took care of the infrastructure leaving the setting up of the restaurants to the entrepreneurs, the rapid set-up of petrol stations stretched the capacity of the entrepreneur to as he tried to keep up by putting up a restaurant in each of the new stations.

Case B entrepreneur also considers the cost of monitoring franchisees to be higher than in the case of monitoring company-owned franchises and this is because according to him, there is need to invest in an infrastructure for checks and controls to ensure that what the entrepreneur is monitoring is correct and that there's integrity of the system unlike when monitoring own outlets. Furthermore, Case B points out that the support mechanism also increases cost since the franchisee that is indeed an entrepreneur in his or her own right, running his or her business using your brand, has to be convinced on the need for compliance to the franchise standards. This he indicates is quite a challenge as the franchisee has to delicately balance between the franchisor's needs and their desire to maximise earnings at whatever cost.

In terms of resources, Case B entrepreneur indicates that financial resources were a key motivation for him to franchise as internal resources were stretched hence he needed to bring in more resources to grow his company-owned outlets. He also considers financial capital generated through issuing of franchising rights as low risk and low cost but insists that the franchisor must invest in the right infrastructure to look after and support franchisees so as to ensure that franchisees also succeed hence increasing the opportunity to increase his revenues in the long term.

Case B entrepreneur believes that franchisees only contribute knowledge and expertise over the period once they have established themselves within the franchise system as they start challenging the franchisor which leads to business growth however at the onset, they contribute very little since the concept is still new to them hence limiting the flow of knowledge. He however notes that his franchisees, both current and the past, do appreciate running their businesses under Case B franchise network as they have access to an established brand, systems and control. The fact that the brand has public goodwill according the entrepreneur or rather there is an increased awareness about the brand enhances its attractiveness to franchisees.

Moreover, the training and marketing support provided by the franchisor and knowledge shared across the network on operational improvements and best practices also bears well with the franchisees.

The entrepreneur reports that there are both positive and negative experiences of using franchising to expand one's business as shown in Table 4.8 below.

| **Positive Experiences** | **Negative Experiences** |
|---|---|
| • Assists and supports other entrepreneurs in setting up their businesses.<br>• It also creates an opportunity to grow the brand in terms of size and scale.<br>• Franchising enables the consolidation of low cost and low risk funds for marketing and working capital.<br>• Improves the relationship with financial institutions once the brand is established due to confidence in the franchising model and in the end enables franchisees to access capital under the same.<br>• Running a business using a still new concept in Kenya gives one an opportunity to be in the media which serves as a good public relations tool for the business. | • Lack of control of the business implies that the franchisor can only advice and not directly intervene.<br>• Lack of recourse when a franchisee contravenes the franchise agreement due to the sluggish nature of the Kenyan judicial system that does not bear well for businesses.<br>• Lack of control on what can happen since one mistake in one outlet can adversely affect other outlets hence the brand is exposed to high reputational risk especially where quality of food and behaviour of franchisee/staff is concerned.<br>• The cost of enforcing compliance to standards by franchisees could end up being higher than the benefits accruing from the arrangement.<br>• Monitoring franchisees' revenues in the case of revenue based royalties could be highly compromised where the integrity of the systems used us questionable such as when franchisees |

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|---|---|
| | beat the system to evade capturing all the information. This he indicates is much easier nowadays due to the existence of the Kenya Revenue Authority's tax registers which can be used to track the revenue. |

Table 4.8 above shows the positive and negative experiences of Case B entrepreneur in using franchising to expand his business.

### *4.3.3 Franchising Strategies Used by Case B*

Case B entrepreneur prefers and has so far only used direct franchising as a licensing form which he considers as a pure franchising agreement that offers him total control of the system with no exclusivity to any of the franchisees. He also points out that for smaller franchise systems, direct franchising makes sense and so even at the level where he had 11 franchise outlets, the scale was not big enough to justify use of area development or master franchising. Direct franchising despite being favourable for his size of operations has not delivered 100% success rate as many of the franchisees who were within his system started to disregard the franchise agreement signed with the franchisor and when the same were cancelled, the recourse process through the Kenya courts ended up being too expensive and lengthy which was not good for the business.

In terms of strategy when setting up a new outlet, the franchisor was responsible for carrying out all the feasibility studies as well as zoning of territories taking into account the demographics in the different areas before signing off a new outlet. According to the entrepreneur, it is important for a franchisor to consider the target market condition and whether it has the characteristics among the population that the franchisor is looking for. In Case B, the franchisor was targeting areas with middle and upper class population who could appreciate the product offering and hence be attracted to the outlets. One of the strategies that Case B used in opening new outlets was conversion where he converted a coffee and snack outlet into a franchise outlet. He however points out that it was not a complete conversion as the previous occupier was just vacating the premises and so space was being freed up. He also believes that using the conversion strategy to grow the number of outlets could be expensive if one was to consider of converting all areas to the franchisor's standards e.g. brand, assets etc and though he has considered using it before, he finds it is too expensive.

The advantages and disadvantages of using direct franchising, the only licensing form that has so far been used by Case B was given as the same ones on Table 4.8 above.

### *4.3.4 Firm Capabilities Critical for Successful Franchise System Development*

Case B strongly recommends that for an SME to develop a successful franchise system, it is paramount that it develops a number of key capabilities before starting to franchise its brand. These capabilities are such as strong systems and controls, predetermined standard operating procedures with a detailed how-to manual, a strong or recognizable brand; marketing, operations management and accounting capabilities as well as a business set-up that is compliant with existing laws e.g. statutory requirements etc.

He emphasises that it essential for an SME to ensure that it has tested and refined its business model because if a franchisor doesn't define his business model well in advance, the franchisees will end up defining the same in different ways depending on what works for them and this may lead to total disparity between the different outlets thus defeat the essence of franchising. In order to avoid such situations, Case B entrepreneur recommends potential franchisors to ensure that they pilot their business models in different settings before replicating so as to verify whether indeed the business model works, with aspects such as how clients interact with products and services, staffing capacity, procedures as well as other general criteria such as profitability, acceptance by the market, brand growth and public awareness being validated.

Testing of the business model in different settings also assists the entrepreneur to develop his franchise support skills and to verify whether his support structure is in place to support multi-units. The exercise of testing is using the existing outlets is what enables the entrepreneur to develop this capability to support franchisees when they are on-boarded. He recommends that an entrepreneur should first operate 2 – 10 branches of his own at different locations before going the franchising route. This also according to him provides an opportunity to test whether the concept can be successfully replicated in different settings where the suppliers, staff, clients etc are different with each outlet. Table 4.9 below shows the entrepreneur's perspective on the importance of different capabilities for franchising.

| **Capabilities Critical for Successful Franchising** | **Tick if Important** | **Give Reason Why Important or Not Important** |
|---|---|---|
| (a) experience | √ | • Experience is critical for the franchisor to provide much needed strategic and business advice to franchisees. The franchisor has to provide his advice from an experience point of view. |
| (b) brand name recognition | √ | • Considered not important at the onset since the same can be grown through franchising although can be helpful if already recognized. |
| (c) franchisee recruitment and selection skills | √ | • It is hard to tell whether the relationship will work out and just a like a marriage relationship, it has a honeymoon period after which challenges set in. It is therefore essential to understand who are getting into business with thus a need to have in place a procedure for franchise selection. |
| (d) problem solving | √ | • The ability to timely resolve problems is critical in a franchise arrangement. |

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| (e) conflict management/resolution | √ | • This is very important as the franchisor – franchisee is very foundational to the success of the business. It is also important to know how to manage challenges with suppliers, the legal system and banks in order to succeed. |
| (f) monitoring and supervision skills | √ | • Important for success of the franchise business as well as to ensure that the integrity of the monitoring system is maintained. |
| (g) marketing strategy | √ | • The franchisor needs to support the system to grow however through the right strategy but to not that franchisees can't be dictated but can only be advised to follow the strategy. |
| (h) franchisee support | √ | • Important to support the franchisees in marketing, maintaining brand standards, operational procedures and compliance. |
| (i) franchisee relationship management | √ | • Similar to explanation given under conflict management/resolution |

Table 4.9 above shows a list of firm capabilities considered, according to the literature review, as critical for the growth of a franchise system and the scoring by Case B on what is critical or not critical and the reasons why it is important/not important.

The above table shows that Case B entrepreneurs considers all the capabilities essential although some like brand awareness he states that it may not be as critical at the onset but is definitely important as the franchise grows and invites outsiders to take up franchise under its brand. In terms of capabilities whose lack would hinder growth if not developed early enough, Case B lists experience, problem solving and monitoring and supervision skills as essential and states that the rest can be developed over time. He points to his own experience where he found difficulty in developing franchise relationship management skills especially from a compliance enforcement perspective, quickly enough to support his growing business. He however states that his franchisee recruitment and selection skills are what enhanced his ability to objectively select franchisees.

Case B does not consider his franchise system ready to compete with international franchises and he lists the legal clout, the infrastructure and financial muscle behind the international franchises as 3 factors that give them an advantage. When faced with legal disputes such as IP related cases, Case B points out that the international franchises have the capacity to wait out the resolution of the dispute no matter how long it takes due to their capitalization and support system behind them. They also have the ability to intervene at government level through their countries' representatives in Kenya hence getting quicker solutions than a local franchise. He insists that larger franchises as is the case of most international franchises have a higher chance of surviving copyright issues unlike smaller ones, as is the case of local franchises.

He equates the state of the Kenyan franchise industry to where the South Africa industry was more than 20 years ago where international franchises entered the market and started assisting in the development of the sector through the demonstration effect and helped create systems by influencing policy. He however points out that the South African market benefited albeit not from a positive situation as indigenous took off when they started to fill the gap left out by international franchises left due to restrictions slapped on the country as a result of apartheid.

### *4.3.5 Legal and Economic Factors Critical for Franchise Development*

#### *4.3.5.1.1 Economic Factors*

Case B entrepreneur scored as shown on Table 4.10, in relation to the Kenyan context, from a list of the economic conditions generally considered, according to the literature review, as critical for franchising to develop in any economy.

| **Economic Conditions** | **Tick if Important** | **Give Reason Why Important or Not Important** |
|---|---|---|
| (a) Income levels/purchasing power | √ | • The existence of a growing middle class with increasingly disposable income and willing to spend on consumables presents a strong market. |
| (b) market size/demand for products and services | √ | • Homogeneity of tastes globally opens up opportunities for international franchises to enter the market.<br>• Demand however needs to sufficient to support businesses hence very important. |
| (c) growth of the ICT sector | √ | • Franchising works where systems are in place and ICT is critical in supporting these systems. |
| (d) level of investable assets | √ | • Growing number of people with investable assets is important such as the case in Kenya where more Kenyans are willing to invest their Kenyan money in Kenya such as the Kenyans in the Diaspora. |

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| (e) access to finance | √ | • Business growth is financed by personal savings as well as debt hence access to finance is paramount. |
| (f) economic growth | √ | • Economic growth impacts earning potential and availability of funds to invest in any sector thus important as well. |
| (g) level of urbanization | √ | • Growth in urbanization such as the case of Kenya that is being driven by a huge emerging middleclass is a good foundation for business opportunities. However, the effects of urbanization will apply differently in different urban areas e.g. Nairobi is not similar to Kisumu as it is, 60% of the GDP still sits in Nairobi although it is expected that over time, devolution will solve that. |

Table 4.10 above shows the economic conditions critical for franchising development according to Case B.

All the above economic conditions have been affirmed by Case B as critical for the growth of franchising in Kenya. However, the entrepreneur points out that the conditions are not enough and that the needs to create incentives to attract SMEs into franchising for instance, provide tax exemption on capital goods brought into the country such as in the case where the SME is bringing into the country a foreign franchising brand and has to source for recommended equipment or capital goods from a foreign market.

Secondly, he also recommends that taxations should be rationalized to reflect the realities of the specific sector e.g. in the case of restaurants, they should ideally not be paying the 2% catering levy like hotels since they rarely benefit from the fund. In addition, the government should further simplify regulations to ease registration of businesses and ensure efficient and quick resolutions of commercial and IP disputes.

#### *4.3.5.1.2 Legal Factors*

The below on Table 4.11 the legal conditions generally considered, according to the literature review, as critical for franchising to develop in any economy and the scoring by Case B on what is critical or not critical in supporting franchising in Kenya as well as the reasons why it is important/not important.

| **Legal Conditions** | **Tick if Important** | **Give Reason Why Important or Not Important** |
|---|---|---|
| (a) Intellectual property (IP) protection | √ | • Franchising is about brands and brands are central to the concept hence they should be protected from infringement and therefore there is a need to ensure that one's IPs are secured and cannot be interfered with. This is important for growth of franchising and more therefore needs to be done in Kenya. |
| (b) nature of corporate laws | √ | • Corporate laws should be business friendly e.g. registration of SME business should not be too stringent. |
| (c) franchise association | √ | • An association is important for policy advocacy, promoting discipline in the sector and creating awareness. |

| | | |
|---|---|---|
| (d) tax structures | √ | • Tax structure is important since it has a cost implication and should therefore reflect the nature of the business. |
| (e) nature of labour practices | √ | • Labour practices and laws have a cost implication on the business and should therefore be friendly and reflect the economic realities of the time. |
| (f) independence and efficiency judicial system | √ | • Timely judicial support e.g. in IP disputes is paramount since time costs money hence faster service delivery is needed as it builds confidence in international franchises to enter the market. |
| (g) legal enforcement of contracts | √ | • Franchising is founded on contract law and hence its faster enforcement is important in quickly resolving disputes and saving costs. |
| (h) support to SMEs by governments | √ | • SMEs are the bedrock of economic development hence the government needs to support franchising among SMEs to spur economic growth. |

Table 4.11 above shows the legal conditions critical for franchising development according to Case B.

Case B supports all the above legal conditions as important and needing attention in order for the SMEs in Kenya to adopt franchising thus enabling franchising to flourish in the country. To further enhance the legal framework in Kenya, Case B proposes that the government needs to promote aware of the franchising concept among Kenyans in general and in the business community as a whole by clearly explaining what it is and the nature of contractual agreements and the implications thereof. The government also needs to enhance the resolution of disputes within the judicial system while the same time simplifying the tax regime to promote adoption of franchising.

## 4.4 Key Informants

Key informant 1 (KI-1) is an expert in franchise development having been involved in consulting on setting up of franchise businesses in Africa for both domestic as well as international investors and has direct experience running his own franchise business in Kenya. Key informant two (KI-2) is a legal expert in commercial law especially in matters related to intellectual property whereas key informant 3 (KI-3) works with a government agency tasked with the responsibility of attracting foreign investors to and facilitating them in Kenya. Lastly, key informant 4 (KI-4) is also a government employee involved in policy development to improve the business climate in Kenya, for both local and international investors, with a focus on SMEs.

### *4.4.1 The Current State of Economic Conditions in Relation to Franchising and Improvements Needed to Promote the Development of Franchising among SMEs in Kenya*

Majority of the key informants interviewed believe that the Kenyan economy is attractive for both domestic and international franchises. They enumerated the sustained economic growth, the growing middle class and increasing income levels among many Kenyans, specifically the middles class and rapid growth of the ICT sector in the country as some of the reasons why the country is ripe for franchising.

KI-3 however pointed out that despite the above positive developments, there were still a number of barriers to supporting rapid growth of franchising in the country. He specifically pointed out that the level of living standards amongst majority of Kenyans was low and therefore despite the increase in the number of Kenyans within the middle class bracket, the market was still not big enough to support too many a number of franchises. Another let down according to him is the fact that there is still a limited appreciation among many Kenyans or lack of development of taste for luxurious goods and services which could limit the establishment of franchises targeting such markets.

In terms of the level of investable assets among Kenyans to buy franchise licenses, there was a great appreciation among all the key informants that the growth in income levels among Kenyans and the remittances by Kenyans in the Diaspora could play a key role in contributing to the growth of franchising. KI-1 pointed out that there were more Kenyans within the country and in the Diaspora that were more and more willing to invest their own resources in Kenya as has been evidenced by the rapid growth of the real estate industry but for them to invest in franchises, more awareness needs to be created to highlight the opportunities available in that sector. KI-2 on the other however thinks that the amount of investable assets held by Kenyans was still low and given the challenges in accessing finance from banks for businesses, it may still not be possible for many Kenyans to acquire franchises. His argument is supported by KI-3 who indicates that despite improvements, Kenyans were still not doing well in terms of developing a savings culture unlike in other regions such as Asia hence limiting their ability to take up opportunities as they arise.

The level of urbanization in Kenya according to KI-1 is good for franchising development as it creates opportunities for increased markets for franchises, many of which operate from urban areas. However, KI-1 and KI-4 explain that challenges such as insecurity, unemployment and poor infrastructure could still hamper development of franchising if not addressed. KI-2 on the other hand, while supporting the relationship between high rate of urbanization and growth of franchising, points out that with the devolution in Kenya, franchises will most probably develop around counties with international franchisors partnering with local business people or choosing to start franchises on their own.

The importance of ICT is supporting the development of franchising was highlighted by majority of the interviewees. KI-1 pointed out franchising only flourishes where there are systems in place and ICT was a great facilitator for establishing systems and structures in franchising. KI-2 and KI-4 highlighted the operational and cost efficiencies that ICT brings in business such as enabling faster communication, payment systems, knowledge access and exchange and faster decision making, ingredients that are important for franchising to succeed, just like any other networked business.

The key informants highlighted, according to Table 4.12 below, a number of areas that need action from the government, in order to create the right economic conditions for both Kenyan SMEs and international franchises to venture into the country.

| **Right Economic Conditions to Promote Greater Adoption of Franchising Among Kenyan SMEs** | **Right Economic Conditions to Promote the Entry of International Franchises into Kenya** |
|---|---|
| • Create incentives such as tax exemptions on imported capital goods and VAT exemption on a case to case basis to encourage more investments especially in cases franchises have to import goods that are not readily available in Kenya.<br>• Scrapping of the 2% catering levy charged on restaurants as very few restaurants benefit from the fund.<br>• Awareness creation by the government on the concept of franchising, how it works, challenges, opportunities etc to enable Kenyans appreciate the obligations of being a franchisor or franchisee hence enabling greater appreciation of franchising | • Give breaks to international franchises on capital investments as they are a source of future revenue to government as well as create employments for Kenyans.<br>• The government needs to proactively market the country to international franchises as a good environment for setting up franchises as the country is ready for the same.<br>• The general business environment is important in attracting international investors hence the government needs to simplify taxation rules, registration etc while continuously improving on the infrastructure to increase reliability and reduce the cost of |

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| relationships.<br>• The government needs to promote deeper access to finance by SMEs by creating incentives for banks to invest in the sector e.g. by creating risk sharing mechanisms and availing more information to banks on SMEs to reduce the perception of risk.<br>• The government needs also to promote access to skills development by SMEs so as to enhance their business management and technical skills and increase the survival rate of businesses.<br>• Additionally, the government needs to improve on the general business environment so as to ease the process of setting up and running businesses e.g. registration, licensing, infrastructure, etc. | doing business.<br>• The government agencies tasked with the role of promoting Kenya as an investment destination need to enhance their service offering to attract foreign investors. |

Table 4.12 above shows the policy improvements needed in Kenya to promote franchising development according to the key informants.

### *4.4.2 Current State of Legal Conditions in Relation to Franchising and Improvements Needed to Promote the Development of Franchising among SMEs in Kenya*

A sound and functioning legal environment is critical for the development of private enterprise as well as franchising as indicated by all the interviewees. Most of them however believed that despite the existence of a good legal framework in Kenya that is necessary for the growth of franchising, institutions tasked with the role of licensing businesses, dealing with legal disputes and the processes used in resolving disputes were not functioning properly hence creating a tough environment for franchising to flourish. KI-1 was of the view that there are too many loop holes within that can be used to beat legal processes in Kenya with KI-4 adding that the pace of the judiciary in resolving commercial disputes still needed to be enhanced despite the latest improvements.

KI-1 highlighted that many larger international franchises required that disputes around intellectual properties and other related commercial disputes be resolved within a year, a target that we are yet to meet as a country in many such cases adding that the backlog of cases and insufficient capacity in the judiciary was not helping the matter. He pointed that for international franchises, it is easier for those that have global clout to use the same to protect their brands from infringement or even to push for quick resolution of commercial disputes but the same may not be true for local franchises that have to bear with the challenges posed by our judicial system. He proposes that the government needs to build more courts, higher more judges, train judges and lawyers on the concept of franchising and related laws and deal with corruption in the judiciary.

KI-4 supports KI-1's view that the execution of laws on IP protection, enforcement of contracts such as in franchise arrangements and resolution of disputes around IP or contracts needed further improvement in Kenya to promote the development of franchising in the country. KI-1 points out that it is still too expensive to take legal action and get a quick resolution hence hindering many investors from going to court, which increase the cost of doing business, forcing some to count their losses, develop other new opportunities, scale down or quit their business altogether. He laments that Kenya is an environment that doesn't support and understand franchising.

KI-2 however thinks that the country not only has a sound legal framework including ICT laws, intellectual property laws, contract laws which are straight forward in terms of managing relationships such as in franchising but also a judiciary that has competent judges who are well versed on commercial law. He suggests that what is needed more in Kenya is the creation of awareness among business people on the nature of franchise development and related costs and lengthy processes, the nature of franchise relationships and available arbitration mechanisms available in the country yet underutilized. He insists that since commercial disputes are grounded on contract laws, they are therefore straight forward matters that can easily be resolved depending on how well one is prepared to present their case hence should not be a cause for worry to either local or international franchises on matters related to independence of judges. He points out that franchises should be ready to pay the required fees to hire competent lawyers to advice them and represent them in such cases.

He is supported by KI-3 who points out that indeed commercial courts have been set up in Kenya to handle commercial disputes such as in franchising agreements. While acknowledging past failures in timely resolution of such disputes, he adds that with the ongoing reforms in the judiciary, things have and will continue to improve. He states that in the meantime, arbitration would be a more reasonable process to resolve commercial disputes and therefore the government should develop a clear process for arbitration in franchising disputes which should be embedded in franchise contracts.

On the issue of SME development and related legislation in Kenya, KI-3 gives the example of the MSE Authority Act as a sign of great strides in developing the SME sector in Kenya. KI-4 adds that there have been indeed some great improvements in Kenya over the past 10 years especially under the MSME Competitiveness Project funded by the World Bank that sought to address a number of key challenges that hinder private sector development especially among SMEs. He therefore says that the environment is supportive of SME development but indicates that more still needs to be done especially in relation to access to finance by SMEs, access to business and technical skills development and finally in the general business environment such as licensing, taxation and infrastructure. KI-1 on the other hand suggest that what is needed to spur SME development is less regulation and reduction of red tape setting up of businesses and simplification of taxation regime. He concludes by saying that the government needs to simplify regulations and increase the efficiency of existing systems to create a supportive environment.

# CHAPTER 5: ANALYSIS AND DISCUSSION OF THE FINDINGS

## 5.1 Introduction

This Chapter presents the analysis of the information collected during the research process and discusses the findings of the study while relating them to the research questions and the conceptual framework. This has been structured along the research questions while also incorporating the conceptual framework.

## 5.2 Environmental Conditions Necessary for the Growth of Franchising

As detailed in the literature review in Chapter 2 of the study, environmental conditions within a certain country have a great influence on the growth and development of the franchising sector with different economic, demographic and legal and/or political factors shown to have a bearing on the development of the concept within an economy. The literature reviewed shows that international franchisors associate the condition of the external environment in a target market to potential benefits. The findings of this study conducted in Kenya have found mainly similarities but also some differences on the importance of the above factors in determining the growth and development of franchising in an economy. The researcher however focused only on economic and legal factors in seeking to understand how important they are in influencing the growth of franchising in Kenya. This was achieved by asking specific questions to both franchisors and key informants.

The findings of the study showed that economic growth in general impacts the earning potential of people within an economy and the availability of funds to invest in any sector hence is a critical factor to consider when looking at the growth and development of franchising. The size and positive growth of the economy according the literature reviewed and the 2 cases studied is important as it eventually determines the size of the potential market for franchises and the purchasing power of the target population. The higher the rate of growth of an economy according to the findings, the more attractive the country becomes to franchisors as they see this as an opportunity to tap into the potential market developing in the country due to increasing income levels, demand for and appreciation for different and higher level goods and services. For instance, according to Case B entrepreneur, the growth of the middle income generating population in Kenya who form a larger part of the target market for many franchises especially those within the retail sectors (food, clothing, etc) presents an attractive proposition for franchises within the said sectors to enter into the market or if already active, to expand their operations into other areas so as to tap into the market. The study however found out that the middle class bracket must be sizeable enough and growing to support increasingly large number of franchises with the population also developing a taste for different goods and services, a mark that Kenya is yet to achieve but has shown the potential of getting there.

Similar to the findings of the literature reviewed in Chapter 2, the level of urbanization was also highlighted by the study as a key indicator that there is a potential market developing within the urban areas, which are mostly the target areas for franchises. It was pointed out by Case A entrepreneur that populations living in urban areas have a higher appreciation for fast food and hence their growth presents the potential to grow franchising businesses in retail fast food. Case B entrepreneur affirms this view by adding that in many ways, urbanization is mainly driven by the emergence of a middle class which is a good foundation for business opportunities but goes ahead to caution that the effects of urbanization may present varying results with some markets being more attractive than others depending on the purchasing power and tastes of the consumers among other factors. He gives the example of Nairobi and Mombasa where people in the former region are more inclined to eating out with the people in the latter region preferring food cooked at home hence presenting different dynamics for franchises within the food business targeting both regions. Additional challenges that come with urbanization such as insecurity, unemployment and poor infrastructure were captured by the study as issues that needed to be addressed by authorities in order to avoid reducing the attractiveness of the country for business.

The level of disposable incomes and willingness to spend on consumables are also considered as important factors by both local and international franchises when choosing either to enter a market or expand their operations within the same market if already in operation according to the literature reviewed and findings of the study. This is because higher and increasing levels of individual income enhance the purchasing power of the target market and also helps to generate strong demand for the intended goods and services, especially as the population increasingly develops their appreciation. Additional to that, the savings culture and availability of investable assets within an economy also determines whether the franchises within an economy are able to attract franchisees to buy into their franchise rights as highlighted by both the literature reviewed and the findings of this research. According to Case B entrepreneur, the more citizens are willing and able to invest their own resources within their economy, the more it presents franchises with an opportunity to attract franchisees that are able to afford to purchase franchise rights from their systems. He gave the example of the current scenario in Kenya where remittances by Kenyans living out of the country have been on the increase, hence presenting a good opportunity to franchises to attract some of these funds into their businesses by selling franchises to relatives of Kenyans living abroad.

Successful franchising according to the study is anchored on the availability and use of robust systems to build, manage and monitor the operations of the business with systems such as quality control systems, stock control systems, accounting and point of sale systems being central to this. According to the findings of the study and the literature reviewed, ICT is therefore a critical enabler of these systems and hence a great determinant of the level of growth of franchising within an economy. The study showed that beyond control and management systems, technology assists in marketing e.g. through mobile communication, social media and sales through online ordering systems while facilitating payments through mobile, cards and over the internet. Technology is also critical in integrating all the above systems to a central system hence enabling efficient management of operations and cost reduction. The literature reviewed shows that franchises are therefore very keen to evaluate the level of development in the ICT sector in making their decisions to either enter into new markets or expand their operations in existing markets.

Access to capital or finance by both the franchisors and their franchisees is also an important factor that determines the growth and development of franchising in an economy as shown by both the literature reviewed and the responses given by the respondents in this study. Case A entrepreneur emphasises that finance is important in not only establishing a franchise system but also in financing its growth, funding new strategies and any other changes in the systems to accommodate the new growth. He recommends that the government should consider setting up a fund to provide financing to SMEs to develop franchising concepts, market development and to acquire franchisees so as to promote the concept more in Kenya. Case B entrepreneur adds that beyond personal savings and funds from family and friends, access to credit from financial institutions is therefore important in financing the growth of a franchise system. Lack or availability of reasonable access to financing will therefore determine the pace at which the franchising sector will develop within a given economy.

The 2 entrepreneurs interviewed in this study did not however indicate the importance of macroeconomic stability as highlighted by Sanghavi (1998) and the structure of the economy as pointed out by Alon and McKee (1999) in franchising development. These factors according to the literature reviewed are considered by international frachisors as they seek new markets to expand their brands. The explanation here could the fact that since the 2 entrepreneurs are based in Kenya with no current plans to expand of the country in the medium term consider the economy stable and open for business hence it is not yet an issue of concern as there are no comparisons to be made yet.

The existence of a sound and effective legal environment is critical for the development and growth of private enterprise such as franchising as revealed by the study. However, the study also noted that it is not just important to have a sound legal framework but also to have the institutions mandated to operationalize and apply the law effective in carrying out their duties so as to ensure that laws achieve their intended purposes.

The findings of the study revealed that franchisors consider franchising to be about brands and therefore brands are central to the franchising concept. In that case, the entrepreneurs emphasized the need for the existence of intellectual property (IP) laws to facilitate the registration and protection of one's IP e.g. trademarks, copyrights etc. Case B states that without the existence of protection of IPs, the growth of franchising in Kenya would be hampered as anyone can just decide to infringe on another business person's IP at will, which can easily spell the death of a business. This is supported by the literature reviewed which shows that one of the issues that international franchises consider when evaluating potential markets is how well IPs are protected as well as the ease of resolution of IP disputes.

Second to IP laws is contract laws according to the study, which the respondents mentioned are important in defining and managing the relationships between franchisors and their franchisees. They define roles and responsibilities, accountability structures as well as conflict resolution mechanisms whenever there is a contract related dispute. The franchisors consider the ease of enforcing contracts within a country as an important indicator for ease of doing business as it ensures that contentious issues are quickly resolved hence saving costs. It is evident from the study that there is a general trend in Kenya of not respecting contracts as well as other people's brands with business people breaching agreements and infringing on others IP rights. The 2 franchisors interviewed mentioned numerous cases of their franchisees going against the franchise agreement in one or several ways or other businesses trying to copy their brands. They also reported challenges addressing the issues effective and in a timely manner through the judicial system.

The study as well as the literature reviewed highlighted the importance of an independent and efficient judicial system in supporting the development of franchising. Given the unique nature of franchising and the centrality of brands to the success of a franchising, any brand or intellectual propery related dispute between either the franchisor and franchisee(s) or any other external party needs to be fairly and quickly resolved so as to avoid the loss of business time and unnecessary injury to the concerned brand. The findings revealed that despite Kenya having competent judges who are well versed on commercial laws, there is still a huge challenge when it comes to the speed at which cases are resolved, especially touching on IP. There have been some improvements but the study shows that there is still a general feeling that the length of time taken to resolve matters is not friendly to businesses as it takes too long hence leading huge legal costs and lost time being incurred by entrepreneurs. One of the entrepreneurs who has had such a case abandoned the matter due to the dragging of the case and in that process lost a considerable amount of funds in forgone revenues from franchising fees and in legal fees.

Lack of confidence in the judicial system and its processes is also not good for franchising development with some respondents reporting that there were still too many loopholes within the Kenyan judicial system through which a legal process could be beaten e.g. the existence of corruption in the judiciary. The literature reviewed showed that international franchisors are concerned at the level of corruption within a country before they engage and it does not help when corruption is rife in the institutions that are supposed to facilitate justice and fairness in an economy such as the judiciary. The lack of awareness on the concept of franchising among the Kenyan public and the legal fraternity is also pointed out as a hindrance to the concept's development in the country according to one of the franchisors but his argument is refuted by one of the key informants who has a legal background who argues that given that franchising in grounded on contract law and the fact that Kenya has got competent judges who understand commercial law, it was therefore a matter of presenting a convincing case to get a fair judgment.

Beyond the judicial system, the regulatory framework and the institutions mandated to implement the same are critical for supporting the emergence and development of franchising according to both the findings of the study and the literature reviewed. Issues such as business friendly corporate laws, tax structures and labour practices are mentioned as some of the factors that are important in franchising development. Corporate laws starting from registration of businesses, requirements on ownership structures, capital requirements and reporting regimes should be developed to ease the starting and running of businesses according the franchisors interviewed. The study revealed that it still takes a long process to register a business in Kenya which does not create an easy environment to start a business or formalise informal businesses. One of the experts interviewed indicates that the reduction of red tape, less regulation and the simplication of the tax regime as important to support franchising development.

Tax structures that are in line with the realities of each sector are seen to be more supportive according to the study with both of the cases studied as well as one of the key informants pointing out that the 2% levy charged on restaurants and fast food retailers as unnecessary due to the fact the such businesses do not benefit in any way from making the contribution unlike hotel businesses. The same goes for labour laws according one of the franchisors who points out that since labour practices and laws have a cost implication on the business, they should therefore be friendly and reflect the economic realities of the time. However, the other franchisor interviewed considers labour laws, especially where the franchisor has few company-owned franchises within the system, as less critical since the franchisor is largely not responsible for managing the human resource in the franchised outlets but further states that since it affects the franchisees, it can therefore not be largely ignored.

The existence of a franchising association is also noted as important for franchising development. The literature reviewed shows that the existence of effective self-regulation, through a franchising association is attractive to international franchisors who see this as an indication of a friendly environment for franchising. An association is especially important in a fleding franchising industry like Kenya where stringent corporate laws may stiffle its development. This is in line with the findings of the study with franchisors stating that an association is important for policy advocacy, promoting discipline within the sector, sharing knowledge and new insights among members as well as creating greater awareness of the concept in the country.

## 5.3 Strategies that SMEs Can Apply for Successful Franchising

Given the nascent nature of franchising in Kenya and the few number of indigenous franchises in the country, the study was only able to carry studies on only 2 franchises that are also between 4 – 16 years old and having varied successes in establishing and running franchises.

The literature reviewed highlighted different strategies that franchises are known to use in entering new markets or expanding their operations within the same markets.

The strategies were categorised in terms of licensing forms i.e. direct franchising, master franchising and area development as well as according to how the franchise determines how to enter a new market i.e. first mover or early entry, platform or beach head and lastly conversion strategies. The study revealed that the franchises in Kenya that were covered by the study have only used direct franchising so far in growing their franchise outlets with each business having similar or differing reasons for choosing the licensing form. The 2 franchisors interviewed seem to agree that direct franchising is the best option for a young and developing franchise system as it gives them more control over the franchise system thus enabling them to strengthen their brand and operational support systems before they reach a critical stage where they can start exploring master franchising and area development. It allows the entrepreneur to directly intervene in cases where there are challenges while at the same time allowing greater interaction with consumers who provide insights on how they perceive their brand, information that is critical for improving the product and service offering.

Direct franchising therefore gives the franchisor the opportunity to move beyond piloting into running several outlets thus allowing the franchisor to refine the business model further, develop robust management systems and supply chains, steps that are important before exploring the other options. Despite their choice of direct franchising over the other 2 options, the study shows that it has not been success all the way for both of them. Both have faced different challenges such as enforcing franchising agreements especially regarding payment of royalty and compliance to the standards of the brand in terms of product offering among other issues. Case A reported franchisees introducing unsanctioned products with Case B facing even greater challenges with collection of royalties from franchisees who refuse to make good their payments, forcing him to scale operations from 11 franchise outlets to only one company owned outlet over the last 6 years due to bottlenecks within the Kenyan judicial system in assisting him address this challenge.

Both entrepreneurs, according to the findings of the study agree that direct franchising is the best at the early stages of development but it seems that the lack of enforceability of contracts coupled with inefficient and costly dispute resolution mechanisms makes its a challenging task developing a franchise system in Kenya. These challenges would probably also plague a franchisor using either master franchising or area development licensing forms. Case A also points out that the nature of the Kenyan market in terms of knowledge of the franchising concept could also be greatly limiting the development and use of the other licensing forms.

None of the entrepreneurs has explored the use of either first mover, platform or conversion strategies in expanding their businesses and this may be due to the fact that both the cases interviewed were or are still establishing their outlets within existing networks of retail fuel stations. Their locations are therefore predetermined by the oil companies that own the fuel stations. Despite this, they reckon that the conversion strategy, unless the costs of converting the outlet is taken up by the franchisee, would be very expensive due to the capital outlay of transforming them to the franchisor's standards in terms of branding, layout, assets, etc.

## 5.4 Firm Level Capabilities that SMEs Need to Develop for Successful Franchising

For SMEs that choose franchising to grow their businesses or entrepreneurs that want to start franchises, the study has shown that they need to develop different capabilities along their businesses' development stages if they are to be successful in applying the concept, most of which are supported by the literature reviewed in Chapter 2 above.

Central to franchising is the existence of robust and functioning systems without which a franchisor would not be able to manage his franchise system, according to Case A. These systems according to the findings of the study and the literature reviewed are such as quality control, stock control, monitoring, accounting and point of sale systems. The 2 entrepreneurs interviewed agree that over and above having the systems in place and ensuring that they are working, a potential franchisor must also develop standard operating procedures with a detailed how-to manual for guiding franchisees on how to run their outlets including matters as sourcing for supplies, production, marketing and sales, staffing, customer service and delivery etc.

The above capabilities according to the study and the literature reviewed can only be developed through piloting of the franchise idea as the initial stage where the potential franchisor develops and refines their business model by testing the product offering, marketing strategies, staffing procedures as well as the pricing policy among other aspects in an outlet. Case B entrepreneur recommends that any SME intending to go the franchising way must ensure that they have tested and refined their business model so as to come up with a solid business format failure to which the franchisees they bring on board will end up defining the same in different ways depending on what works for them hence defeating the essence of franchising, which is about replication. Case B entrepreneur adds that an unsound business model will also pose implementation challenges to franchisees as they will not know how to effectively run a franchise outlet.

After the franchisor has piloted the franchise business idea and is confident that he has a sound business model, the findings of the study and literature reviewed show that the next logical step is to develop a detailed operating manual that details, based on the experience gained from the pilot outlet how, to operate a franchise outlet, products and services to be offered, production procedures, shop layout and floor plan, operating hours, staffing procedures, training manual among other important information needed to run a successful franchise outlet. Case A entrepreneur recommends that the business model should be well documented such that anyone anywhere can easily run a similar business with ease.

Once there is a tested business model in place with a supporting operating manual, the entrepreneurs interviewed recommend that the potential franchisor should not jump into franchising his outlets to independent entrepreneurs or franchisees just yet but should first of all gain experience in running different units at a time, hence validating the findings of the literature reviewed in Chapter 2. The potential franchisor according to the findings of the study is advised to move beyond the single outlet and to pilot the developed business model using several company owned outlets in different contexts. Case A entrepreneur states that this allows the franchisor to test the replicability of the business model using different staff, customers, premises, suppliers among other variables to determine what changes need to be made to make it more solid. He further points out that this also allows the entrepreneur to check on how the product is prepared in the different settings, the time taken to prepare the same and the consistency of taste and the suitability of the pricing policy among other important aspects, a process that may demand some adjustments for each outlet depending on the size and the context in which it is situated.

Case B entrepreneur adds that the process of testing the business model in different locations gives the entrepreneur relevant experience and prepares him to be able to provide the relevant support mechanism that is critical for enabling the franchise system to grow. Some of the critical capabilities for successful franchising according to literature reviewed are a strong franchisee operational support system that addresses issues such as getting the best location, marketing, staffing and supply chain development, capabilities that Case B entrepreneur suggests are developed as one tests the replicability of their business model in different contexts. He says that the process not only enables the entrepreneur to develop his franchisee support skills but also to verify whether his support structure is in place and strong enough to support multi-units of franchise outlets further adding that his personal recommendation is for a franchisor to operate between 2 – 10 company owned outlets in different locations before giving the rights to independent entrepreneurs.

There are other capabilities that the study, according the responses of the entrepreneurs interviewed; recommends that a franchisor should develop over time to enable him develop a successful franchising business. However, the literature reviewed shows that these capabilities can only be developed once the entrepreneur starts on-boarding independent entrepreneurs into his franchise system. Skills such as franchisee selection and recruitment, franchisee monitoring and supervision, franchise relationship management and conflict management and resolution can only be best developed once the franchisor has independent entrepreneurs on board as franchisees unlike only when running company owned outlets which are normally run by managers employed by the franchisor. For instance, to develop superior franchisee recruitment and selection skills, the literature reviewed shows that each entrepreneur needs to develop their own selection criteria while evaluating and refining the same with experience, an argument supported by the findings of the study.

The findings of the study show that all the entrepreneurs interviewed believe that beyond experience, a sound and replicable business model and effective franchisee support system, all the above listed skills or capabilities are important for the franchisor to develop over time as the business grows in order to successfully franchise. What came out clearly from the study is that there is not a defined way of determining a set of skills that an entrepreneur needs to develop at the start up, emerging and developing stages of his franchise business. The 2 entrepreneur reported differently though with some similarities, what they considered important capabilities to develop in the early stages of their businesses, what skills they found difficulty in quickly developing as their businesses grew and demanded more of them and lastly what skills they thought greatly enhanced their abilities to better manage their franchises over time. What was similar for the first category of skills was experience mainly gained at the business model piloting and replication stage, with franchise relationship management being the only similar skills the 2 cases found hard to develop quickly and finally franchisee recruitment and selection skills being a similar skill that both entrepreneurs pointed out as what they thought greatly enhances their abilities to better manage their franchises.

## 5.5 Economic and Legal Policy Recommendations for Franchising Development

The findings of the study have ended up in a number of policy recommendations so as to create a conducive environment to promote the greater adoption of franchising by SMEs in Kenya which has far reaching economic benefits if successful, as shown in the literature reviewed. The recommendations also relate to the promotion of the entry of international franchisors into Kenya who are critical according to the literature reviewed in creating a demonstration effect to local small businesses hence providing them with insights and know how on franchising, which in the end leads to greater adoption of the concept by local entrepreneurs.

In terms of creating the right economic conditions for the promotion of franchising in Kenya, the entrepreneurs and key informants interviewed recommended the need for the government to not only address a number of existing challenges but also highlighted a number of initiatives that the government could come up with to make it easier for franchising to flourish in the country.

The government needs to create attractive incentives in order to attract SMEs into franchising. Some of the incentives mentioned were tax exemptions on imported capital goods as especially in situations where the SMEs are forced to import goods that are not readily available in the country. For instance, some international franchises that have operations in Kenya require that their local franchisees or even their own outlets to use certain type of equipment or inputs that are either not available locally or the quality of the same available here does not meet their standards. In such cases, many potential franchisees end up being discouraged from taking up the franchise rights due to the high start up or running costs, something that could in some instances be addressed through tax incentives as explained above. This leads to lost opportunities for future revenue by the government, unrealized knowledge transfer into the economy as well as employment opportunities for Kenyans.

There is also a general consensus that the 2% catering levy charged over and above 16% VAT on sales of restaurants and fast food outlets is not serving to better the business environment for the these types of businesses. The argument is that the levy is intended largely to ensure that the country has a constant supply of highly qualified hospitality workforce by subsidizing their training at government institutions such as the Utalii College but the 2 entrepreneurs and the franchising expert interviewed state that only the hotels benefit from hiring these qualified staff for 2 main reasons i.e. they can’t afford to pay salaries for such staff and if they were, the qualified personnel has a preference for hotels. This means that they are forced to hire unqualified staff and incur costs training them to their required standards hence increasing their operating expenses and hence eating into their revenues. They recommend that the government should limit the 2% levy charge to hotels and such business that directly benefit from the catering levy fund.

The government is advised to create more awareness among the Kenyan general public and the business community about the concept of franchising, how it works, opportunities and challenges thereof etc to enable Kenyans not only know about franchising but also appreciate the obligations of being a franchisor or franchisee hence enhancing greater appreciation of the nature of franchising relationships. This is foreseen assist in reducing the current level of ignorance and increase the appreciation and respect of the contractual obligations between franchisors and franchisees which could in the end reduce the potential for disputes such as on intellectual property issues.

Beyond awareness creation, there is a recommendation for the government that should consider setting up a special department within the relevant government ministry that also works with the relevant agencies tasked with promoting Kenya as an investment destination to promote franchising locally as well as to international franchisors with the aim of attracting them into the country. The same department it is suggested could also develop a franchising development fund which can be utilized in financing the development and growth of indigenous franchises by providing them with funds for market development as well as availing franchisee finance to enable them acquire franchise outlets. The government could also consider working with financial institutions to increase long term and sustainable financing to SMEs who want to franchise their businesses or entrepreneurs who want to acquire franchising licences. This its recommendation can be done by creating incentives for financial institutions to venture into the sector by creating instruments such as risk sharing facilities or guarantee funds as well as availing more information to financial institutions on SME franchising to reduce the perception of risk and highlight the available opportunities.

To increase the chances of the SMEs that choose the franchising route to remain sustainable into the future, the government needs to come up with a way of addressing the general lack of business and technical skills among many entrepreneurs by promoting access to relevant, easily accessible, flexible and affordable skills development programmes. This is important in enhancing the survival rates of SMEs, which is still very low in the country.

On matters concerning the legal policy environment, there is a majority view that the country has a sound legal framework that could be useful for franchising development however; it is the operationalization of the available mechanisms that seems to have a problem according to the findings of the study. The greatest challenge in the country seems to be the lack of efficiency in resolving commercial and more related to franchising, intellectual property disputes which implies that such cases take longer than necessary hence impacting negatively on the revenues of the businesses concerned as well as exposing their brands to negative information which is not good for the businesses. The recommendation is that the government further enhances the capacity of the division of Commercial and Admiralty of the judiciary that is tasked with hearing these types of cases to hear and resolve these matters as quickly as possible so as to save businesses time and money. This is especially important to international franchises, especially the most established ones, which are keen on how long it takes for matters such as IP disputes to be resolved before entering an economy, according to one of the key informants.

Alternatively according to one of the key informants and as a short term to medium term measure as the government continues to improve the service delivery levels of the judiciary, the government should develop a clear process for arbitration in franchising related disputes which should be embedded in all franchise contracts hence providing the franchisors and franchisees with a secondary avenue for resolving their issues. His recommendation is supported by the legal expert among the key informants who insists that the currently available arbitration mechanisms in the country are grossly underutilized and hence could present an equally good alternative for resolving disputes. The government also according one of the entrepreneurs needs to improve on the protection of trademarks by enhancing the requirements to include even colours associated with a specific logo and then linking that up with the products and services being offered under that trademark. This he suggests will limit the chances of copy cat businesses, as is the common case in Kenya, to offer the same products and services using similar colours or near similar logos hence confusing clients.

Lastly, in terms of SME development the government is requested to further improve on the general ease of setting up and doing business in Kenya by reducing the time it takes to register a business and simplifying licensing regimes and tax structures which could encourage more people to get into business, formalize their businesses and hence further promote franchising as a viable way of growing one's business.

# CHAPTER 6: CONCLUSIONS AND RECOMMENDATIONS

## 6.1 Introduction

This Chapter presents the summary, conclusions and recommendations of the study. The conclusions have been reached based on the findings of the study and are in line with the research objectives.

## 6.2 Summary

Franchising can only take root and grow in a context where there is an increasing number of citizens who are entering the middle income earning bracket, living in urban areas and whose earnings and disposable incomes are increasing over time hence presenting a ready and growing market for products and services. Increased savings from the growing incomes also creates opportunities for franchisors to attract franchisees that are able to purchase rights to run businesses under their brands thus growing their businesses. An enabling environment through the existence of good infrastructure, ICT, access to finance, sound corporate laws, friendly tax structures, autonomous and effective judicial system are important for the growth of franchising and must therefore be continuously enhanced.

SMEs in Kenya need to come up with the right strategies and develop the right competencies if they are to build successful franchising businesses. This takes time from piloting the franchise concept they have, starting with one franchise outlet to prove the concept and into several other company owned outlets to test the replicability of their business model. While at it, several capabilities need to be developed, with some being acquired proactively or deliberately especially at the initial development stages of the business, with others naturally taking shape as they continually move their businesses from piloting, to replicating and into fully franchising the same to outsiders.

Franchising is still at the nascent stage of development in Kenya and therefore has a long way to go before we can fully exploit the potential benefits of the sector as has been experienced in other countries where the industry is vibrant. For the sector to further develop in the country, suitable economic and legal conditions need to be in place to support its development as has been detailed in previous chapters. In many ways, quite a considerable number of the foundational economic and legal conditions are in place to support the development of the sector in Kenya but a number of areas still need more focus by the government and the private sector in order to accelerate the growth of the still emerging industry that has the potential to create numerous small businesses and add more jobs into the economy while generating additional and much needed revenue for the government.

## 6.3 Conclusions

The basis of the concept of franchising is being able to successfully and sustainably replicate an already tested and proven business model in different contexts thus giving the franchisor an opportunity to grow their business much faster than in a conventional business by leveraging on other people’s resources, both human and financial, to achieve his goal of expanding his business. It has been shown that franchising has led to faster growth of the SME sectors in many countries such as the US and UK and has a higher survival rate of small businesses than in the case of conventional businesses. Given the great role that SMEs have to play in the development of the Kenyan economy, through revenue generation and job creation, it is therefore safe to conclude that franchising could and should have an important and critical part to play in the development of the SME sector in Kenya and should therefore be considered and adopted by the government and the private sector as a strategy for SME development in Kenya.

## 6.4 Recommendations

Based on the findings of the study, the following recommendations were made;

1. The government through the Ministry of Industrialization and Enterprise Development or any other relevant government agency to consider setting up a department solely focused on developing and implementing the right economic and legal policy frameworks to support the growth and development of franchising in Kenya.
2. The government to develop strategic partnerships with Capacity Building Institutions such as business schools, technical institutes, consultancies and

capacity building non-governmental organizations to build the capacity of SMEs going into franchising so as to enable them succeed in their ventures.

3. The government and the private sector to support the revival and capacity building of the current franchising association and mandate it among other responsibilities to create awareness about the concept in Kenya as well as spearhead industry self-regulation.

## 6.5 Recommendations for Further Research

1. Future studies should investigate what are the critical capacity building needs and appropriate financing instruments for franchises as they move from the emerging, developing and mature stages of their life cycle.

2. There is a need to evaluate the effectiveness of the IP laws in Kenya in protecting IP rights of individuals and businesses and whether they meet international standards.

3. There is also a need to establish whether the available IP and commercial dispute resolution mechanisms available in the country are business friendly in terms of the time taken and cost incurred in the process.

## 6.6 Limitations of the Study

The study focused on only 2 franchise businesses within the larger hospitality industry. The findings of this study can therefore used to generalize to the whole of the franchising sector but can only be used to offer explanations that may or may not be applicable to other franchising businesses within Kenya. The study is therefore limited in its understanding of franchising in other industries such as non-food retailing businesses, personal and business services and rental services among others. Key challenges faced during the study were lack of access to all the targeted franchise businesses and key informants and lack of access to financial performance information from the cases studied.

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## APPENDIX I: INTERVIEW GUIDE FOR FRANCHISORS

**LETTER OF INTRODUCTION**

My name is ____________________________ from **Strathmore Business School**. I am undertaking an exploratory study on 'Franchising as an SME Development Strategy in Kenya' as part of my Masters in Business Administration (MBA) course. The purpose of the study is to understand the state of franchising within SMEs in Kenya. Given your experience in franchising, you have been selected as a valuable participant in the study.

Anything you tell me is confidential. Nothing you say will be personally attributed to you in any report that will result from this interview. The report will be written in a manner that no individual comment can be attributed to a particular person nor will it mention any individual/organization/business by name.

All individuals' and organizations' names shall be replaced with pseudonyms to protect their real identities. All information requested on your organization/business will be held with utmost confidentiality and shall not be shared with third parties. Please note that your participation is voluntary. Do you have any questions before we begin?

The interview questions shall cover the following key areas;

1. General information about your business
2. Motivation for choosing franchising as a business strategy
3. Strategies applied in franchising your business
4. Firm capabilities necessary to develop a successful franchise system
5. External environmental factors that influence motivation, strategy and firm capabilities and how they enhance/limit franchise development

Please find below my contacts in case you would like to get in touch with me in the future:

Samuel Ndonga | P.O Box 61572 – 00200 Nairobi | +254-721-905967 | sam.ndonga@gmail.com

**INTERVIEW GUIDE FOR FRANCHISORS**

**QESTIONS FOR THEME #1**

The aim of the questions under this theme is to have a general idea about your business, its origin and development as well as your future plans for the business.

1. How do you define your business in terms of legal form and economic sector?
2. How long have you operated the franchise business and did you have any prior business or relevant working experience before starting your franchise business?
3. What products and service do you offer?
4. Who are your competitors and what do you consider to be your competitive edge??
5. What is the size of your company? i.e. no. of franchise outlets (company-owned and franchisee-owned. Future plans on the size of your company?
6. What is the average cost of setting up a standard franchise unit within your system?

**QUESTIONS FOR THEME** #2

The aim of the questions within this theme is to understand the reasons behind your choice of franchising as business growth strategy (business expansion or entering new markets) as well as your experiences (both positive and negative) in franchising so far.

1. Why did you choose to use franchising to grow your business rather than opening purely company owned and managed outlets? (Probe question: Was it the need for rapid geographic expansion? Increase organizational sales? Rapid market expansion?)
2. Based on your experience so far, do you consider the cost of monitoring franchisees to be lower than that of monitoring company owned managers/employees? (If yes, go to question 3, if not, probe why not)
3. What specifically from a monitoring cost perspective motivated you to go the franchising way? (Probe questions: Was it the need to reduce your cost of monitoring (and controlling) managers/employees? Was it the need to delegate the running of your outlets? Was it the need to reduce the burden of having to supervise a growing staff number?)

4. Looking at the key resources needed to grow a business e.g. financial, human, knowledge of markets etc, were you motivated by the scarcity or cost of any of these or other resource to choose franchising? (Probe questions: If so, which resources were you interested in leveraging on to enable you expand your business rapidly? Financial? Managerial? Knowledge of local markets?)
5. From your experience, do you consider franchising to be a low risk/low cost method for the franchisor in acquiring financial capital for business expansion?
6. From your experience, has franchising enabled you to get access to skilled managers/employees? Was this a motivation for you to choose franchising?
7. Do your franchisees consider being within your franchise network more advantagious to opening their own independent businesses? (Probe questions: What is it that attracts them to the system? Brand? Proven business method? Support system?)
8. What have been the positive and negative experiences of using franchising to expand your business?

**QUESTIONS FOR THEME** #3

The aim of the questions under this theme is to understand the franchising strategies that you have applied when expanding your business/entering new markets, what has worked and not worked and why.

1. In your franchise system, which licensing form between direct franchising, area development and master franchising do you use? (Probe questions: How many franchises are under each form? Which licensing form do you consider to be the best option and why?)
2. Has any of the above licensing form failed to deliver the intended benefit? If so, why do you think it failed?
3. Before using any of the above form of licensing, do you consider the target market condition(s), how and when to enter the target market? (Probe question: If so, when do you prefer to use direct licensing, area development or master franchising?)
4. Have you ever converted an independent business or a franchisee from another franchise system into your franchisee/franchise outlet? (Probe question: If so,

how many and were they independent businesses or franchisees within other systems?)

5. If you have not used conversion strategy, do you see this as a potential strategy for you to expand your business? (Probe questions: Why or why not?)
6. What have been the positive and negative experiences of using direct franchising? Area development? Master franchising?

**QUESTIONS FOR THEME** #4

The aim of the questions under this theme is to identify what you consider based on your experience so far as the critical firm capabilities that a franchise operation needs to develop in order to successfully expand and maintain growth.

1. What do you consider to be important capabilities which a firm that wants to use franchising as business expansion or market entry strategy should develop prior to franchising?
2. How important is it to have a refined and solid business model (easily replicable business concept) before starting to franchise/replicate?
3. What is the importance of piloting one's business concept before replicating with outsiders? (Probe questions: What aspects of the business model need testing? Product or service, marketing strategies, staffing procedures and pricing policies?)
4. Why is testing of the franchise model in additional/different locations important? (Probe questions: Testing replicability of the concept in different contexts (staff, customers, premises, supply chains etc)? Should this be done before franchising to other people? Why or why not?)
5. Among the following capabilities, which one(s) do you consider critical for successful franchising? Why or why not?

| **Capabilities Critical for Successful Franchising** | **Tick if Important** | **Give Reason Why Important or Not Important** |
|---|---|---|
| (a) Experience | | |
| (b) brand name recognition | | |
| (c) franchisee recruitment and selection skills | | |
| (d) problem solving | | |
| (e) conflict management/resolution | | |
| (f) monitoring and supervision skills | | |
| (g) marketing strategy | | |
| (h) franchisee support | | |
| (i) franchisee relationship management | | |

6. Which of the capabilities listed above based on your experience in franchising would greatly hinder growth if not developed early in the development of the franchise system? Any others?
7. From your experience, what capabilities, listed above or otherwise,
    a. Have you found difficulty in quickly developing as your firm grows?
    b. Have enhanced your ability to better manage the franchise: relationships, growth, challenges etc?
8. Would you consider your franchise system ready to compete with international franchise brands entering the market? Why or why not?

**QUESTIONS FOR THEME** #6

The aim of the questions under this theme is to identify what you consider, based on your experience, as the critical legal and economic conditions necessary for your franchise operation (and other franchises in Kenya) to successfully expand and maintain growth.

1. What among the following economic conditions do you consider important for franchising to develop in Kenya and why?

| **Economic Conditions** | **Tick if Important** | **Give Reason Why Important or Not Important** |
|---|---|---|
| (a) Income levels/purchasing power | | |
| (b) market size/demand for products and services | | |
| (c) growth of the ICT sector | | |
| (d) level of investable assets | | |
| (e) access to finance | | |
| (f) economic growth | | |
| (g) level of urbanization | | |

2. What can the government do to improve the relevant economic conditions so as to support the growth of SMEs through franchising?
3. What among the following do you consider as critical legal conditions needed to support the development of franchising in Kenya?

| **Legal Conditions** | **Tick if Important** | **Give Reason Why Important or Not Important** |
|---|---|---|
| (a) Intellectual property (IP) protection | | |
| (b) nature of corporate laws | | |
| (c) franchise association | | |
| (d) tax structures | | |
| (e) nature of labour practices | | |
| (f) independency and efficiency judicial system | | |
| (g) legal enforcement of contracts | | |
| (h) support to SMEs by governments | | |

4. What can the government do to improve the legal framework so as to support the growth of SMEs through franchising?

# APPENDIX II: KEY INFORMANT INTERVIEW GUIDE

**LETTER OF INTRODUCTION**

My name is ____________________________ from **Strathmore Business School**. I am undertaking an exploratory study on 'Franchising as an SME Development Strategy in Kenya' as part of my Masters in Business Administration (MBA) course. The purpose of the study is to understand the state of franchising within SMEs in Kenya. Given your responsibility within ______ you have been selected as a valuable participant in the study.

Anything you tell me is confidential. Nothing you say will be personally attributed to you in any report that will result from this interview. The report will be written in a manner that no individual comment can be attributed to a particular person nor will it mention any individual/organization/business by name.

All individuals' and organizations' names shall be replaced with pseudonyms to protect their real identities. All information requested on your organization/business will be held with utmost confidentiality and shall not be shared with third parties.

Please note that your participation is voluntary. Do you have any questions before we begin?

The interview will focus on legal and economic conditions necessary to promote the growth of franchising in Kenya.

Please find below my contacts in case you would like to get in touch with me in the future.

Samuel Ndonga | P.O Box 61572 – 00200 Nairobi | +254-721-905 967 | sam.ndonga@gmail.com

## KEY INFORMANT INTERVIEW GUIDE

## ENVIRONMENTAL FACTORS AFFECTING FRANCHISING

The aim of the questions below is to identify the current state of the legal and economic conditions in relation to franchising as well as the improvements needed to promote the development of franchising among SMEs in Kenya through both domestic and international franchising (franchisors).

### Economic Conditions

1. Do you consider the Kenyan economy to attractive enough to encourage the development franchising among SMEs?
2. In terms of income levels or disposable income, is Kenya attractive enough for both local and international brands to set up franchises?
3. Are the levels of investable assets among Kenyans attractive enough for both local and international brands to set up franchises?
4. Is the rate of urbanization a good indicator for potential market for both domestic and international franchisors?
5. Do you consider the growth of the ICT sector relevant for the growth of franchising? If so, why?
6. In your opinion, what more needs to be done by the government and the relevant authorities in
    a. Creating the right economic conditions to promote greater adoption of franchising among Kenyan SMEs
    b. Attracting the entry of international franchises into Kenya?

### Legal Conditions

7. Do you consider the legal framework in Kenya supportive of the development of franchising either through domestic franchising or entry of international franchisors?
8. Are the corporate laws friendly to franchising development? What needs improvement?
9. Are our laws on protection of intellectual property (IP), resolution of IP conflicts and enforcement of contracts sufficient to build the required level of confidence

among domestic or international franchisors? What gaps exist and what needs to be done to fill them?

10. Is the effectiveness and independence of our judicial system sufficient to build the required level of confidence among domestic franchising or international franchisors? What gaps exist and what needs to be done to fill them?
11. Do we have regulations supportive of the development of SMEs in Kenya e.g. easing access to capital etc? What gaps are there and what needs to be done?