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I. INTRODUCTION

Microfranchising, an emerging business model in the developing world, is effectively enhancing bottom of the pyramid markets (BOP) or markets serving the poorest of the poor in developing countries. This Article seeks to explain how and why microfranchising has emerged as a business model in the developing world. Approaching microfranchising from the perspective of the franchisor, this Article proposes a model to determine when microfranchising might present a viable option for firms seeking to operate in BOP markets.[1]

This Article begins by defining microfranchising and discussing various business environment factors that influence the emergence of this relatively new phenomenon. The Article examines several case studies identifying how various companies throughout the developing world have successfully negotiated their respective nations' business environments to create successful microfranchises. Based on the case studies, this Article will then propose a model predicting that microfranchising will be an effective business model when employment laws are overly rigid, contract enforcement is lax, and tangible assets or specific knowledge that are not normally available in the marketplace are needed for the microfranchisor to distribute or produce its goods. In conclusion, this Article outlines some of the factors for potential firms in this market to consider in determining whether to enter BOP markets. Additionally, this Article speculates that further research will follow this Article to test the model set forth herein.

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1. *See* C. K. Prahalad & Allen Hammond, *Serving the World's Poor, Profitably*, 80 HARV. BUS. REV. 48, 49 (2002).

II. MICROFRANCHISING

As with traditional franchising, microfranchising seeks to replicate[2] a successful business model. However, microfranchising operates on a much smaller scale with start-up costs ranging from \$25 to \$25,000.[3] Microfranchising frequently involves the pursuit of social objectives, such as providing jobs, in addition to strictly for-profit models.[4] While microfinance provides initial capital to individuals lacking credit and therefore lacking a means of securing loans, microfranchising provides existing business models to individuals who may not be natural entrepreneurs.[5] Microfranchising provides a viable business model, an existing brand, business training, and access to a formal supply chain and business support, which drastically increases the odds of microenterprise success.[6] This section will first discuss the emergence of the microfranchising market, followed by a discussion of factors impacting the business environment of the developing world.

A. Factors Explaining the Emergence of Microfranchising

Microfranchising is a relatively recent phenomenon with the majority of microfranchises emerging only in the last few years. Several factors may explain this emergence in relation to economic globalization. With increasing pressure on developing economies to lower trade barriers and reduce bureaucratic restrictions, increased contact with western economies may help promote and standardize

2. Replication involves the geographic copying of a business model, such as the spread of a franchise model. For an exploration of the factors affecting the successful replication of business models, *see generally* Sidney G. Winter & Gabriel Szulanski, *Replication as Strategy*, 12 ORG. SCI. 730, 730–43 (2001); Robert Jensen & Gabriel Szulanski, *Stickiness and the Adaptation of Organizational Practices in Cross-Border Knowledge Transfers*, 35 J. INT'L BUS. STUD. 508, 508–23 (2004); Robert Jensen & Gabriel Szulanski, *Template Use and the Effectiveness of Knowledge Transfer*, 53 MGMT. SCI. 1716, 1716–30 (2007); Gabriel Szulanski et al., *When and How Trustworthiness Matters: Knowledge Transfer and the Moderating Effect of Causal Ambiguity*, 15 ORG. SCI. 600, 600–13 (2004); Gabriel Szulanski & Robert Jensen, *Presumptive Adaptation and the Effectiveness of Knowledge Transfer*, 27 STRATEGIC MGMT. J. 937, 937–57 (2006).

3. JASON FAIRBOURNE ET AL., MICROFRANCHISING: CREATING WEALTH AT THE BOTTOM OF THE PYRAMID 8 (2007).

4. Lisa Jones Christensen, *Alleviating Poverty Using Microfranchising Models: Case Studies and a Critique*, *in* ALLEVIATING POVERTY THROUGH BUSINESS STRATEGY 149, 152 (Charles Wankel ed., 2008).

5. *Id.* at 151–52.

6. FAIRBOURNE ET AL., *supra* note 3, at 34–35.

business practices across the world.[7]

In the past decade, the growth and success of microfinance has redefined perceptions about doing business in BOP markets.[8] Only a few decades ago, most financial firms were reluctant to fund microfinance projects or groups financing such ventures. However, in February of 2008, TIAA-CREF (a U.S. pension fund) and APB (a Dutch pension fund) committed $125 Million USD to Catalyst Microfinance Investors in a private equity fund that will primarily help microfinance firm ASA International expand throughout Africa and Asia.[9] This move is indicative of a new readiness in capital markets to pay attention to developing markets.

Perhaps a more profound phenomenon has been the legitimization of the BOP as a viable market.[10] As globalization connects the world in new ways, new markets have been created and developing markets have become increasingly important.[11] Multinational corporations (MNCs) that previously had no interest in BOP markets have responded to growing pressure to find new markets and expand operations as competition for existing markets has intensified. As a result, the four billion people on this earth with an income of less than $2,000 per year—known as the bottom of the pyramid—that were previously ignored have now caught the attention of a growing number of management scholars and MNCs.[12] These scholars argue that the poor of the world constitute a market that is grossly underserved.[13] They contend that as MNCs profitably engage the developing world, MNCs will expand their own markets, while improving the quality of life of the poor through supplying much-needed products and services.[14] However, little research identifies exactly how MNCs can best enter BOP markets or

7. *See* STUART L. HART, CAPITALISM AT THE CROSSROADS: THE UNLIMITED BUSINESS OPPORTUNITIES IN SOLVING THE WORLD'S MOST DIFFICULT PROBLEMS 3 (2005).

8. *See* Christensen, *supra* note 4, at 149–70.

9. Heather Dale, *Microfinance Investments*, GLOBAL PENSIONS, Feb. 13, 2008, *available at* http://www.globalpensions.com/global-pensions/news/1461581/microfinance-investments?page=gp_display_news&tempPageId=701266.

10. HART, *supra* note 7, at 135.

11. *Id.*

12. *Id.*; *see also* Prahalad & Hammond, *supra* note 1, at 49; V. KASTURI RANGAN ET AL., BUSINESS SOLUTIONS FOR THE GLOBAL POOR: CREATING SOCIAL AND ECONOMIC VALUE 1 (2007).

13. RANGAN ET AL., *supra* note 12.

14. *See* HART, *supra* note 7, at 3–4.

which organizational model ensures a successful entry.[15]

Successfully serving BOP markets will require defying pervasive assumptions of the market and initiating innovative business models.[16] Traditional theories of business operations have generally been formulated in the context of the economically advanced nations—i.e., those with adequate infrastructure and stable conditions. Business environment factors often prevalent in the developing world—corruption, deficient legal institutions, inadequate infrastructure, and widespread poverty[17]—preclude traditional marketing approaches to BOP markets. Given the contrasting conditions of the developing world's business environment, current theory and practice do not adequately explain the best way to operate in BOP markets. While microfranchising may provide an effective model for businesses operating in the BOP, most microfranchising literature addresses only potential advantages for the microfranchisees and not the franchisors.[18] Clearly, a model is needed to explain the conditions in which microfranchising might present a viable option for firms seeking to operate in BOP markets.

B. Factors in the Developing World that Inhibit Traditional Business Models

To understand the role of microfranchising, it is essential to understand the business environment of the developing world. In many ways, developing nations can be extremely difficult places to do business. Microfranchising emerged, in large part, from its success in addressing the traditionally problematic characteristics of the business environment in BOP markets. Various factors that affect the business environment in developing nations do not seem to affect more developed nations, at least not to the same degree.

A general exploration of these factors will aid in understanding the model that will be set forth below, though the application of these factors can vary markedly from one area to the next. The

15. *See* V. KASTURI RANGAN & ROHITHARI RAJAN, UNILEVER IN INDIA: HINDUSTAN LEVER'S PROJECT SHAKTI—MARKETING FMCG TO THE RURAL CONSUMER 1–30 (HARV. BUS. SCH. 2005).

16. *See* Prahalad & Hammond, *supra* note 1.

17. BOP markets encompass over 4 billion people and are characterized by deep poverty defined as an annual income of less than $2,000 USD a year. Many people in BOP markets live on less than $200 USD a year. *Id.* at 49, 51.

18. *See* FAIRBOURNE ET AL., *supra* note 3 (focusing exclusively on the benefits of microfranchising for the microfranchisees).

developing world is hardly a homogenous block of nations, but is a highly heterogeneous group, comprised of differentiated nations with unique cultures, languages, environments, governments, and people. Even within their own borders, developing nations are hardly homogeneous. Furthermore, socio-economic conditions vary widely within each nation, including areas dominated by upper and middle class populations, as well as areas of extreme poverty. This Article focuses on BOP markets within the multiplicity of developing nations.

The following paragraphs outline several factors affecting the microfranchise business model in developing nations. While this list may be neither comprehensive nor uniformly applicable, it illustrates contextual differences between developed and developing nations. In many cases, these environmental conditions limit the growth of traditional firms in developing countries, creating a landscape in which a few powerful and well-connected firms dominate while the rest of the economic activity takes place in simple market transactions.[19] Understanding the context of the business environment in the developing world will increase the ability of firms to operate in these environments, regardless of their specific business model.

1. Poverty

Perhaps the defining characteristic of the developing world is poverty. As evidenced in Figure 1 below, the disparity between the Gross National Income (GNI) per capita in BOP markets and that of Organization for Economic Cooperation and Development (OECD)[20] member nation markets is startling. Poverty stifles two fundamental ingredients necessary for the development of traditional firms. First, the vast majority of people in poverty-stricken nations do not have access to capital to start businesses or to contribute to economic development. Financing is often not available in developing countries, especially to individuals mired in poverty. While microcredit has drastically improved individual lives in developing countries, it has only served millions out of an estimated

19. Tarun Khanna & Krishna Palepu, *Is Group Affiliation Profitable in Emerging Markets? An Analysis of Diversified Indian Business Groups*, 55 J. FIN. 867, 867 (2000).

20. The OECD is an international organization with membership consisting primarily of developed nations in Europe, North America and the Pacific Rim. *See generally* http://www.oecd.org.

four billion people in BOP markets.[21] Second, individuals in poverty generally lack opportunities for education, which is directly linked to productivity.[22] Individuals lacking knowledge and experience have greater difficulty successfully starting a profitable business of any significant size.

Lack of access to education and capital directly affects the day to day operations, and therefore the viability, of businesses from BOP markets. For example, a firm operating in BOP markets often cannot rely on traditional market mechanisms to provide suppliers or distributors because individual entrepreneurs who would normally fill those roles do not have access to the education and capital necessary to create those businesses. Establishing a firm of sufficient size to be a supplier or distributor to an incoming multinational firm often requires at least a modicum of financing. With poverty rates in BOP markets at subsistence levels, even minor financing is often not available and microcredit, when available, is typically not enough to provide the kind of supply or distribution services MNCs require.[23]

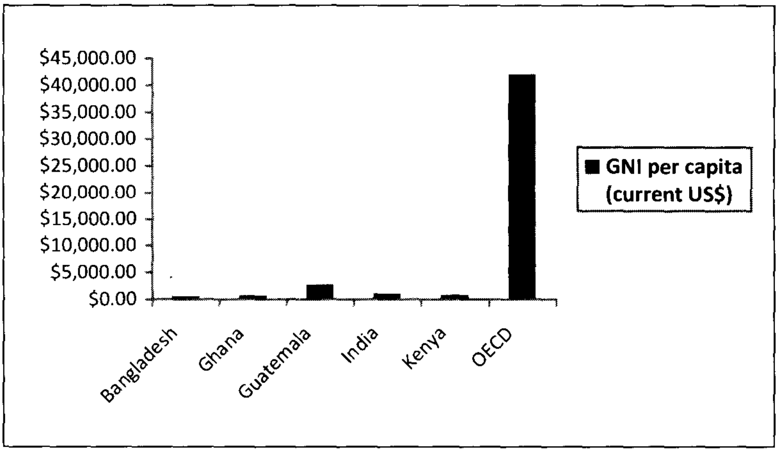

Figure 1: Comparison of Gross National Income (GNI) per capita.[24]

21. Prahalad & Hammond, *supra* note 1, at 48, 49; Press Release, United Nations, UN Launches International Year of Microcredit 2005, U.N. Doc. DEV/2492 (Nov. 18, 2004), *available at* http://www.un.org/News/Press/docs/2004/dev2492.doc.htm.

22. *See* George Psacharopoulos, *Returns to Investment in Education: A Global Update*, 22 WORLD DEV. 1325, 1325–43 (1994).

23. *See* Christensen, *supra* note 4, at 149–70.

24. World Bank Group, Doing Business Topic: Economy Characteristics, http://www.doingbusiness.org/ExploreEconomies/EconomyCharacteristics.aspx (last visited

2. Corruption

Corruption, or the abuse of power for personal or collective gain, is a major hindrance to developing economies.[25] Corruption is most common at the interface between public and private entities, especially when the government must provide necessary services, permits, or licenses.[26] Cumbersome bureaucratic procedures often increase corruption, as each point of contact with an official is an additional opportunity to solicit a bribe.[27] As Figure 2 below demonstrates, while corruption exists to some degree in all countries, extreme corruption is commonplace in developing countries. Corruption substantially increases the cost of transactions and inflates prices through market distortions and inefficiencies, thereby exacting a heavy toll on the economy.[28] These procedures tend to force businesses out of the formal economy and into informal markets[29] where business occurs with less regulatory oversight.

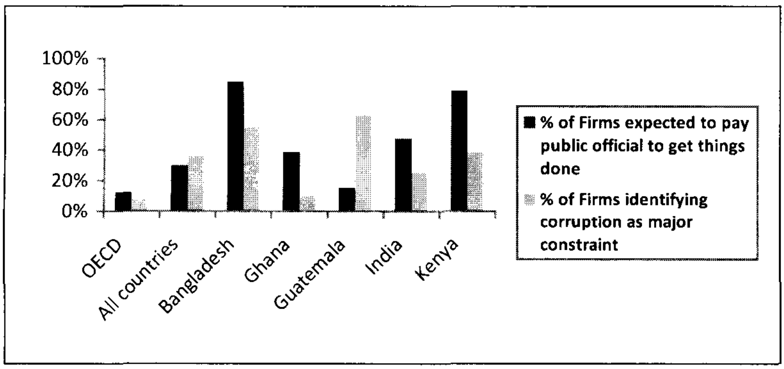

Figure 2: Corruption Comparison Graph.[30]

Aug. 21, 2009).

25. Rick Stapenhurst & Sahr J. Kpundeh, *Introduction: An Overview of the Costs of Corruption and Strategies to Deal With It*, *in* CURBING CORRUPTION: TOWARD A MODEL FOR BUILDING NATIONAL INTEGRITY 1, 1 (Rich Stapenhurst & Sahr J. Kpundeh eds., 1999).

26. *Id.* at 3.

27. *See id.* at 2–3.

28. Stapenhurst & Kpundeh, *supra* note 25, at 3–4.

29. Informal markets are markets for any type of product in which transactions are not taxed or regulated by the government. Other terms for informal market transactions include "off the book," or "under the table" transactions. In emerging economies, as much as 60% of the labor force operates in informal markets. Enrique Ghersi, *The Informal Economy in Latin America*, 17 CATO J. 99, 101–02 (1997).

30. World Bank Group, Enterprise Surveys Topic: Corruption,

3. Employment Law

Establishing employment regulations requires careful balance between the need to protect workers' rights and the need for a flexible and responsive labor force. Overly rigid labor laws may result in reduced job creation, lower productivity, and increased unemployment.[31] In Figure 3 below, for example, the costs of dismissing workers in developing countries is often more than one year's salary—more than double the cost in OECD nations. The developing world is often characterized by overly rigid labor laws affecting hiring, working hours, and dismissals, which force workers into the informal market where no protections exist.[32] The characteristics of labor laws directly affect the costs associated with operating a traditional firm.

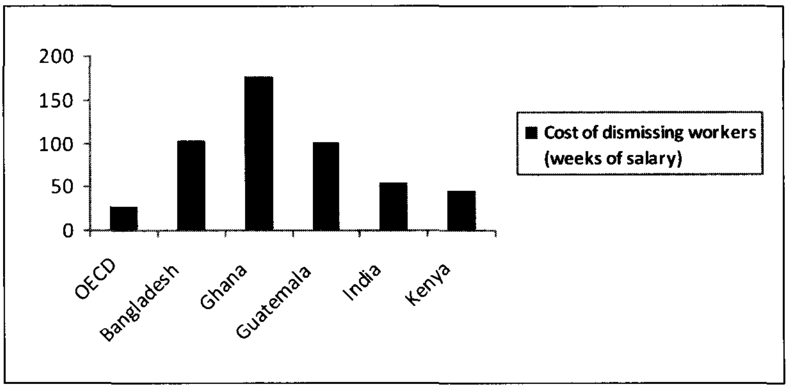

Figure 3: Relative Cost of Terminating Employment.[33]

4. Contract Enforcement

Contract enforcement is a crucial element in understanding how firms are structured. In the absence of a reliable legal system enforcing contract obligations, businesses are unlikely to partner with individuals or organizations they do not know or trust, thus

https://www.enterprisesurveys.org/ExploreTopics/?topicid=3 (last visited Aug. 21, 2009).

31. WORLD BANK, DOING BUSINESS 2009: COMPARING REGULATION IN 181 ECONOMIES 19–20 (2008).

32. *Id.* at 20.

33. World Bank Group, Doing Business Topic: Employing Workers, http://www.doingbusiness.org/ExploreTopics/EmployingWorkers/.

limiting opportunity for increased connections and growth.[34] The data in the chart below demonstrate that contract enforcement in many developing nations requires considerable time and money, effectively preventing the poorer segments of the population a legal remedy to resolve contract disputes.[35] Unreliable enforcement systems, which offer limited options for recovery from a breach of contract, deter larger businesses.[36] Firms who contract with individuals from BOP markets may also find it nearly impossible to locate the individuals if they walk away with firm assets, making it difficult to operate firms in BOP markets using a traditional business model involving employers and employees.

Enforcing Contracts		
Region or Economy	Procedures	Cost (% of claim)
OECD	30.8	18.9
Bangladesh	41	63.3
Ghana	36	23
Guatemala	31	26.5
India	46	39.6
Kenya	44	26.7

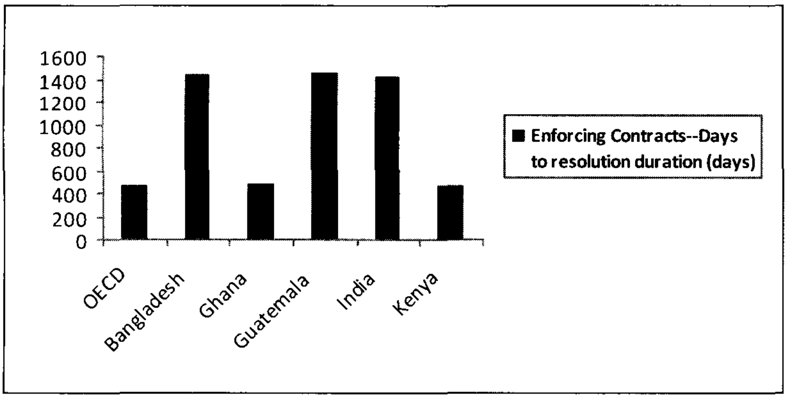

Figure 4: Effect of Lax Contract Enforcement.[37]

34. *See* WORLD BANK, *supra* note 31, at 49.

35. *Id.*

36. *Id.*

37. World Bank Group, Doing Business Topic: Enforcing Contracts, http://www.doingbusiness.org/ExploreTopics/EnforcingContracts/ (last visited Aug. 21, 2009).

5. *Infrastructure*

BOP markets lack the infrastructure required by firms in traditional markets. Developing countries often lack adequate infrastructure, such as roads, bridges, railways, electricity, airports, and communication systems. Even countries that have good infrastructure in more developed areas may lack the same in areas of greater poverty. Therefore, firms face distribution and production challenges as they attempt to build their presence in these areas. Figure 5 below shows costs incurred due to poor infrastructures.

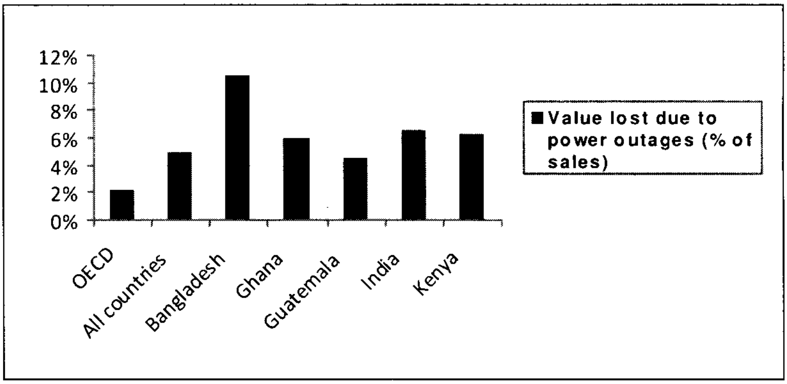

Figure 5: Comparison of Infrastructure Related Costs.[38]

C. *Microfranchising Case Studies*

In light of these contextual factors, we examine case studies to better understand how microfranchising allows certain businesses to succeed at the bottom of the pyramid in the developing world. The following case studies provide insights into why firms entering BOP markets would choose microfranchising as an operational business model.

38. World Bank Group, Enterprise Surveys Topic: Infrastructure, https://www.enterprisesurveys.org/ExploreTopics/?topicid=8 (last visited Aug. 21, 2009).

1. Igloo Ice Cream: Dhaka, Bangladesh[39]

Igloo Ice Cream is the largest producer and distributor of ice cream in Bangladesh. It is a subsidiary of Abdul Monem Ltd., one of the largest conglomerates in the country.[40] Bangladesh is a developing nation with a population of nearly 150 million and a land area roughly the size of Iowa.[41] As of 2007, the GNI per capita (Atlas method) was USD $470.[42]

As indicated in Figures 1 through 5 above, Bangladesh lacks adequate infrastructure, suffers heavily from corruption, and ranks 178 out of 181 economies in contract enforcement.[43] In addition, while the labor laws are reasonably flexible regarding hiring and working hours, dismissals cost businesses the equivalent of 104 weeks of salary per incident.[44] These factors cause Igloo to use a flexible market governance structure, characterized by traditional stores as well as trolleys that operate as franchisees of Igloo's products in normally inaccessible areas.

Igloo primarily distributes its products through local stores. In addition, Igloo operates in public areas such as parks and recreational areas. Igloo has developed a successful microfranchise distribution model to distribute their product in these areas. The microfranchisees utilize a large tricycle, called a trolley, with an insulated container for ice cream. The trolley is equipped with a large umbrella and bears the Igloo brand name. Each trolley is owned by Igloo and costs 60,000 Bangladeshi Taka (Tk), or nearly $900 USD, an amount almost double the yearly GNI per capita.[45] Trolley operators generally come from the poorer segments of society and

39. Information for this case study came from observation, interviews with numerous Igloo microfranchisees in June 2007 and June 2008, as well as an interview with the Dhaka manager of Igloo, Md. Mazidul Hoq, in Dhaka, Bangladesh, June 2008. Chris Sutter, Notes from Personal Observation of Igloo Ice Cream in Dhaka, Bangladesh (June 2008) (unpublished manuscript, on file with author).

40. *See* Abdul Monem Ltd. Company Profile, (2009), http://www.amlbd.com/profile.php.

41. CIA, THE WORLD FACTBOOK: BANGLADESH (2009), https://www.cia.gov/library/publications/the-world-factbook/geos/bg.html.

42. WORLD BANK, BANGLADESH AT A GLANCE (2008), *available at* http://devdata.worldbank.org/AAG/bgd_aag.pdf.

43. WORLD BANK, *supra* note 31, at 49.

44. *Id.* at 90.

45. For comparison purposes, the GNI per capita in the United States in 2008 was $47,580. WORLD BANK, GROSS NATIONAL INCOME PER CAPITA 2008, at 1 (2009), *available at* http://siteresources.worldbank.org/DATASTATISTICS/Resources/GNIPC.pdf.

lack the necessary capital to purchase and operate their own business. To bring the franchise into reach of the franchisees, Igloo accepts a franchise fee of Tk 5,000–6,000 (around $100 USD) for the right to use a trolley and operate the business. This fee guarantees that the franchisee will be responsible for the care of the trolley. In fact, the $100 franchise fee may be facilitated by microcredit, as that sum is generally beyond the means of most operators.

Each trolley operator is assigned a different geographic location. Each morning, the trolley operators buy that day's ice cream at a distribution center, and then return to their areas to sell the product. While pricing is theoretically fixed by Igloo, prices sometimes vary because trolley operators adjust pricing based on demand. Other aspects of the business model, such as product line and advertising, are fixed. The trolley operators' benefit from Igloo's advertising and from the geographic monopoly they enjoy. Trolley operator turnover is high each rainy season when sales decline substantially, but there is a large pool of potential candidates to draw from and finding new operators is never a significant challenge.

2. FanMilk: Accra, Ghana[46]

FanMilk, based in Accra, Ghana, utilizes a model similar to Igloo's; however, Ghana suffers less from corruption and enjoys greater contract enforcement and more flexible employment laws than Bangladesh. Poverty is widespread in Ghana, with the average GNI per capita (Atlas method) at $590 in 2007.[47] In contrast to Igloo whose microfranchise model only supplements its primary store front approach, FanMilk relies entirely on microfranchising to distribute its product. FanMilk's emphasis on selling only in BOP markets, such as slums and busy streets rather than also targeting wealthier areas as Igloo does by distributing through storefronts may account for this difference.

FanMilk's microfranchisees use a tangible asset—in this case a bicycle with an insulated box attached—to deliver the product. Microfranchisees are not used as a means of acquiring resources. Instead, microfranchisees pay a franchise fee (which is less than the

46. Information for this case study came from observation as well as two rounds of interviews with a majority of FanMilk microfranchisees in Accra, Ghana, May–June 2007, and May–June 2008. S. Stevenson, Notes from Personal Observations and Interviews of FanMilk Microfranchisees in Accra, Ghana (Sept. 2008) (unpublished manuscript, on file with author).

47. WORLD BANK, GHANA AT A GLANCE (2008), *available at* http://devdata.worldbank.org/AAG/gha_aag.pdf.

value of the asset) and in turn receive the right to use a company bicycle with an insulated box and operate the business. The business models for how to operate the individual ice cream franchise are fixed and significant adaptation does not occur at the microfranchisee level. The microfranchisees are not assigned a unique geographic area, but rather enter the areas they know best and in which they are likely to be most successful.

3. Honey Care, rural Kenya[48]

Honey Care Africa provides an example of when both specific knowledge and tangible assets (like Igloo and FanMilk) are needed to create a production base. Honey Care is a company that utilizes rural Kenya as a supply base for honey and then markets the honey locally as well as internationally.[49] Similar to Ghana, Kenya enjoys relatively strong contract enforcement, but suffers from corruption and poor infrastructure (see Figures 1 through 5 above). In 2007, Kenya had a GNI per capita of $690 (Atlas method).[50]

Men and women applying to be microfranchisees need not only tangible assets (beehives), as with Igloo and FanMilk franchisees, but also specific knowledge on bee keeping. Honey Care provides individuals with these tangible assets and specialized knowledge through microfranchising. The beekeepers obtain a loan from a local microfinance institution or NGO and use that capital to purchase the hives.[51] Honey Care differs from Igloo and FanMilk because Honey Care requires beekeepers to purchase the necessary assets (the beehives) rather than simply leasing the tangible assets.[52] Honey Care does this to create "a real sense of ownership" on the part of the farmers.[53] Given the relatively low cost of the hives, these requirements do not seem to reflect a strategy to compensate for resource scarcity on the part of Honey Care. Honey Care partners with local NGOs to provide essential training on beekeeping to microfranchisees, which increases standardization of production

48. FAIRBOURNE ET AL., *supra* note 3, at 149–63.

49. *Id.* at 150.

50. WORLD BANK, KENYA AT A GLANCE (2008), *available at* http://devdata.worldbank.org/AAG/ken_aag.pdf.

51. FAIRBOURNE ET AL., *supra* note 3, at 154.

52. *Id.*

53. *Id.* at 159.

processes.[54] The microfranchising structure allows for the transfer of knowledge as well as the assets necessary to produce honey.[55]

4. Community Enterprise Solutions, Rural Guatemala[56]

Community Enterprise Solutions (SolCom) is a social venture based in Antigua, Guatemala and serves rural communities throughout the country. In 2007, Guatemala had a GNI per capita of $2,440, but income distribution is highly skewed, with the lowest 20% holding only 3.5% of the income share in 2000.[57]

SolCom provides numerous products that increase the standard of living for rural Guatemalans, including reading glasses, sunglasses, eye drops, efficient light-bulbs, and water filters. The products are first shipped to headquarters in Antigua and then to regional centers where regional managers are employed. Regional managers oversee *asesores* or salespeople who work in pairs in assigned areas and operate as microfranchisees. These salespeople are independent from the parent company, but wear uniforms, work in assigned areas, receive training, and sell only SolCom products. They conduct sales campaigns generally lasting two days and solicit SolCom's most popular item—reading glasses—by administering free eye exams. Salespeople are trained every six months on how to administer the exams as well as on other aspects of the business. Salespeople work on commission and do not provide an upfront microfranchise fee to SolCom. As is the case for the microfranchises previously examined, SolCom microfranchisees do not require tangible assets to facilitate the sale of their products. In this case, the microfranchise structure is used primarily as a way to transmit knowledge, coordinate activities, and provide access to a formal supply chain, while preserving the independence of salespeople.

54. *Id.* at 150.

55. *Id.* at 155–56.

56. Information for this case study came from observation and interviews with a majority of Community Enterprise Solutions microfranchisees in rural Guatemala, June–July 2008. Jason Fairbourne, Notes from Personal Observation of Community Enterprise Solutions in Guatemala (2008) (unpublished manuscript, on file with author).

57. WORLD BANK, GUATEMALA COUNTRY DATA PROFILE (2008), http://ddp-ext.worldbank.org/ext/ddpreports/ViewSharedReport?&CF=&REPORT_ID=13609&REQUEST_TYPE=VIEWADVANCED&HF=N&DIMENSIONS=20.

D. A Model to Explain Microfranchising at the Bottom of the Pyramid

The following section utilizes the three case studies discussed above to develop a model to explain the incidence of microfranchising in BOP markets. While microfranchising can mitigate some detrimental environmental factors—such as employment laws, contract enforcement, lack of access to financing, and lack of access to education—others are more difficult to allay.

A country's employment laws have a profound effect on a firm's choice of business model. The high cost of firing an employee deters companies from casually entering employment arrangements, so firms either avoid such markets or select alternative business models that require fewer employees. In addition, rigid employment laws in many developing countries increase the cost of traditional firm operations, pushing firms toward other business models. In cases where a country's employment laws inhibit a firm from hiring employees, microfranchising offers an alternative form of governance, giving the firm a more flexible position.[58]

Contract enforcement issues may also lead a firm to choose microfranchising as a business model. Where contract enforcement is an issue, firms generally have two options: they may choose to use simple contracts that are unlikely to be breached, or they avoid contracts altogether by resorting to a pure market approach. Selecting microfranchising as a business model is choosing the first option as microfranchising contracts are often simple and verbal. Microfranchisees are often required to pay a franchise fee in order to receive the right to operate company assets. Such a requirement creates commitment and motivation on the part of the franchisee to follow through with obligations to care for the company assets. If the microfranchisee breaches these obligations, the parent firm retains the franchise fee (which the company would otherwise return upon termination of the arrangement). This simple approach effectively overcomes the obstacles posed by a lack of contract enforcement in the developing world.

58. A traditional firm approach operates with employer/employee contracts. A pure market approach utilizes outside contractors for production and customer/distributors rather than employees (i.e., a firm outsources production to others who it then buys the product from and sells its products to distributors who turn around and sell to the end customer). A microfranchise is a hybrid structure that uses quasi employees. They do not have traditional employment contracts and they own their franchises, but they have at least some contractual obligations with the firm. *See* Oliver E. Williamson, ***Comparative Economic Organization: The Analysis of Discrete Structural Alternatives***, 36 ADMIN. SCI. Q. 269, 269–96 (1991).

Poverty is another BOP market characterization that affects a firm's decision to adopt microfranchising as a business model. Among very poor populations, capital to obtain assets is generally unavailable. Therefore, a firm that requires tangible assets for the production or distribution of its products will not be able to employ purely market mechanisms for this purpose. Instead, these corporations must extend their resources through employees or some form of contracting with another party.

Selecting microfranchising as a business model in poverty-stricken countries is an appropriate solution to doing business for several reasons. The costs of supervising employees who are using company assets may be too high to maintain. While the scarcity of employment options almost guarantees that employees will work very hard, assets employed in distribution of products are of much greater value than an employee's salary. Thus, there is an incentive for the employee to simply take the asset and sell it or use it elsewhere. Given the poor legal infrastructure, it would be nearly impossible for the firm to recover the assets. To monitor every employee as the employee uses the company's assets throughout crowded markets and slums would be an unsustainable cost in most circumstances. Many microfranchises avoid this problem by requiring a franchise fee for the right to use company assets in the distribution process. This fee is generally not equal to the actual value of the assets because, as previously explained, the microfranchisees often cannot access sufficient capital to obtain the assets. However, payment of the fee generally provides enough incentive to prevent theft or abuse of the company's assets.[59]

Lack of access to the requisite knowledge or education to perform efficient, quality work poses another obstacle to working within BOP markets. For example, SolCom employs members of local rural communities to perform eye exams and sell reading glasses.[60] The knowledge to perform these tasks is not usually available within these rural communities,[61] necessitating something closer to a more traditional business model while still ensuring a commitment to a standardized business model. An untraditional business model, such as microfranchising, may be an appropriate

59. This is not to suggest that dishonesty is a defining characteristic of the developing world. Indeed, many industries in the developed world (car rental companies, for example) use the same practice to ensure that their assets are returned safely.

60. Fairbourne, *supra* note 56.

61. *Id.*

approach to educating and preparing people to perform these tasks.[62] Microfranchising provides a model that allows for franchisee commitment to standardization and training while minimizing costs.

Corruption and lack of infrastructure, however, are not easily mitigated by microfranchising. Corruption and power outages affect all business models. For this reason, these two contextual factors, while important, are not included in the model predicting the use of microfranchising.

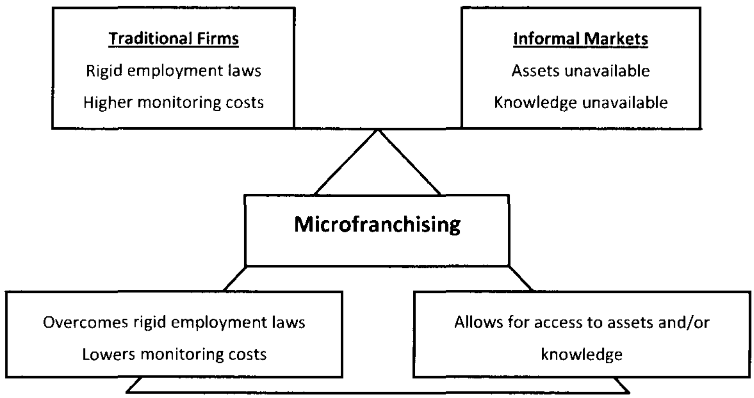

Figure 6: Striking the Balance Between a Traditional Business Model and Informal Market Transactions.

III. CONCLUSION

Traditional business theory and practice do not account for key environmental differences in the developing world. The emergence of microfranchising is driven by five basic factors: (1) the existence of rigid employment laws; (2) a lack of access to capital due to widespread poverty and inadequate financial institutions; (3) the need to operate local units with assets that are valued at multiples of a typical weekly or monthly wage; (4) a lack of education and knowledge in local markets; and (5) inadequate legal institutions, which makes the enforcement of labor contacts difficult and increases the costs of monitoring employees.

62. *See* J. C. Spender, *Making Knowledge the Basis of a Dynamic Theory of the Firm*, 17 STRATEGIC MGMT. J. (SPECIAL ISSUE) 45, 46–47 (1996).

Firms considering entry into BOP markets should consider the following factors in determining whether to microfranchise. Firms first need to consider the assets and level of knowledge necessary for distribution or production of their products in relation to the relative level of poverty of the target market. If these assets or knowledge do not exist in the market, pure market transactions may be unsuccessful because suppliers may be difficult to locate and independent distribution channels may be difficult to establish. Firms should then consider the target market's employment laws and its degree of legal protection. Where employment laws are overly rigid, a hybrid model such as microfranchising may be most appropriate because terminating employees may be extremely costly. Where legal protection is unavailable or insufficient, firms may also need to utilize a microfranchise model that creates commitment and motivation in its microfranchisees and safeguards firm assets from opportunistic employees. Given the characteristics of the developing world, microfranchising may provide an attractive model for many firms.