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Social Franchising:
Why the International Donor and Impact Investing Community Should Pay Attention to Social Franchising

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Introduction

For the past three years, D2international (D2i) – The Deloitte Government and Public Services (GPS) flagship international social impact program, founded on the belief that doing good is good business - has developed the Social Franchising (SF) Community of Practice (CoP) who has advised successful East African and Latin American social enterprises on using the franchise model as a tool to scale – a process known as social franchising. The goal of Social franchising is to exponentially scale the impact of each dollar for donors and impact investors while removing barriers to entry and creating economic opportunity through franchisee ownership and employment. Entrepreneurs can own a business with very little upfront capital which enables them to have organic growth in their communities. Furthermore, it is important to highlight that the Bottom of the Pyramid is a $5T market which underscores the opportunity to achieve financial return and meet critical needs[1].

D2i's SF CoP has been able to see how social franchising ventures have struggled to access the necessary funding to continuously drive growth and impact in their communities. This white paper's intention is to show funders the opportunities that exist in investing in these ventures and provide guidance on the challenges we have learned about through our work.

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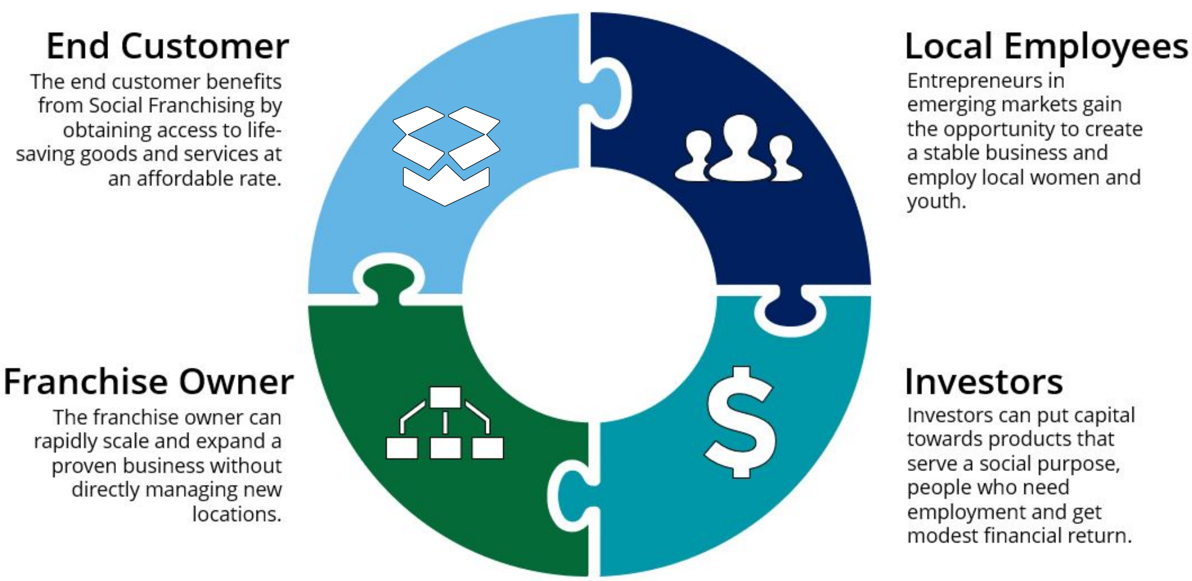
Social Franchising Opportunities

Investing in Products that Provide Social Impact and Financial Return

Investors can play a key role in the Social Franchising ecosystem by providing the necessary capital that may positively impact the other stakeholders with an incentive.

For those interested in investing their capital in a business that will likely yield financial returns and improve the lives of their customers and employees, social franchising offers a compelling solution. Figure 1 illustrates the various stakeholders in the social franchising ecosystem that investors have the potential to impact. The World Bank estimates that the shortfall of Sustainable Development Goals (SDG) financing is $2.5 trillion a year[2].

Figure 1: Benefits to Various Stakeholders in the Social Franchising Ecosystem



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Social Franchising Opportunities

As interest in financing companies that address the SDGs increases, some are concerned that the investment dollars will go only to large corporations that are more likely accept multi-million-dollar cash infusions and investors will miss out on smaller, earlier stage businesses which are often women-led[3]. Social franchising efficiently channels investment capital to where it is needed in development and help communities in need. Social franchise enterprises address at least two SDGs (shown in Figure 2): one or more related to the good/service the business is providing and one related to creating employment opportunities (SDG 8).

Figure 2: Sustainable Development Goals. Source: Global Education Magazine[4]

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Social Franchising Opportunities

Social Franchising allows impact investors to use their money effectively and see the impact of their dollars to exponentially scale social impact. Social franchising mitigates the risk of investing in social enterprises because the business model has already been proven by the parent company, so capital will likely be invested in entrepreneurs who have high incentive to scale the business and continue the cycle of profit, scale and impact. From a return-on-investment perspective, a 2012 study estimated a 2 – 10% ROI for a €100K investment in existing social franchises with 5% default rate[5].

Case Study: Total Impact Capital Invests in Jibu

The Enterprise: Jibu offers affordable, clean drinking water in six African countries, addressing SDGs 3, 5, 6 and 8. Since its creation in 2012, Jibu has created at 122 franchises, translating to at least 2,600 jobs, half of which are held by women and youth. It has distributed over 183 million liters of water to people who may have otherwise not been able to afford clean drinking water. As of February 2018, Jibu raised $7 million in funding[6].

The Investor: Created in 2010, Total Impact Capital is a venture capital and private equity organization that creates impact investing vehicles designed to make the world a better place[7].

How It Works: The financial incentive for investing in Jibu comes from its modest regular returns and low risk profile. Its franchisees have autonomy to run the business and generate a profit for themselves, creating a virtuous cycle of profit and scale for both investor and franchisee. This incentive scheme provides investors with the potential for exponential social impact and financial return. Total Impact Capital has realized Jibu's potential by acting as a financing vehicle for franchisees. Total Impact Capital purchases loans that Jibu has made to franchisees because they have full confidence that these loans will be paid back. This transaction allows Jibu to free up cash to lend to additional new franchisees and continue the cycle of scale and impact, while providing Total Impact Capital with low-risk returns. An additional way Total Impact Capital reduces risk is to collateralize assets purchased by franchises.

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Social Franchising Challenges

Despite the many benefits of social franchising, it is relatively new in the impact space which has caused a lack of funding and led to a significant challenge for organizations reaching their maximum potential. It is critical that the social franchise has a positive track record and strong business proposition to decrease investment risk as much as possible. Impact investing differs from commercial investing because franchises must convince investors to support despite limited profitability due to the naturally high risk and low margins associated with social franchising. In considering this funding challenge, it is important to note that an overall lack of data surrounding social franchising is an additional obstacle that affects any conclusions from this section.

Lack of Funding

Finding sufficient and consistent funding is the primary challenge for many social franchises looking to scale. Oftentimes, enterprises that adopt the franchising method have funds but are not well suited for franchising. There is a high initial capital requirement, and not enough funders are willing to provide resources to help social enterprises grow and scale. For example, funders may not account for the unique and challenging social franchising landscape that requires significantly high costs to be met up front that help lift franchisees off the ground in unfamiliar environments. It is vital that the franchisor uses a financial model that specifies how they will likely meet their critical mass of franchisees, which is the number of franchisees that must be open for a set period of time for the business to breakeven. According to John Simon, a founding partner at Total Impact Capital, it usually takes franchisees six to nine months to become financially self-sufficient. If it takes much longer the business will likely fail.

This period, often called the “Valley of Death,” is when investment is most critical and often hard to acquire. The “Valley of Death” is defined as the stage where the franchise grows but cannot increase its own revenues and has not yet established a strong enough track record to attract investors. This challenge is especially prominent in Africa, where investment in social franchises focuses on basic human needs, but unfortunately, such goods yield very low profit margins.

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Social Franchising Challenges

Considerations to Mitigate Challenges

As potential investors grapple with creating financial vehicles in midst of the challenges franchisors are facing, they should consider the following:

- **Flexible Funding Requirements:** Funding should be tied to results and ability to show credible paths forward rather than micro-level outputs.
- **Funding Franchisees in Addition to Franchisors:** As referenced in the case study above with Total Impact Capital and Jibu, financing franchisees enables them to expand their operations while allowing the franchisor to use freed up funds in other endeavors important to the business.
- **Patience:** Given that situations don't always go as planned, it is important that investors are patient to ensure lessons learned are applied so that desired outcomes are achieved.

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Conclusion

Given the CoP's experience on working with Social Franchising organizations and examining the funding they receive, we firmly believe it merits further investment and consideration from the international donor and impact investing communities. Social franchising's potential to scale fast while staying true to local knowledge and creating local jobs makes it an exciting model for meeting growing global needs. As the population of the world continues to expand and resource access shrinks due to many factors, including climate change-related destruction, it will only become more imperative that each dollar spent funding social impact work be as efficient as possible. Social franchising can be an important tool to help the international community meet that goal.

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