FARM SHOP: LESSONS LEARNED FROM SCALING A SOCIAL FRANCHISE

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Farm Shop: Lessons Learned from Scaling a Social Franchise

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Farm Shop: Lessons Learned from Scaling a Social Franchise

In recent years, the concept of social franchising has attracted increasing interest for its potential to achieve social impacts in underserved markets in ways that are financially self-sustaining and scalable.[1] Many organizations in various sectors – such as Sanergy in sanitation, VisionSpring in eyeglasses and the HealthStore Foundation in primary health care clinics – have begun to test this potential through establishing and growing social franchises to address underserved needs in health, education, sanitation, vision, energy, agriculture and other areas.[2]

Social franchising (or microfranchising) is the application of principles of business franchising (a standardized and replicable business system for a business unit (shop, clinic, etc.) that reduces risk for the owner-managers) to achieve a social objective. In addition to providing a social good to end users, social franchises also support local business owner-entrepreneurs through support systems (training, access to financing, an efficient supply chain, etc.) built into the business model. The parent franchisor organization identifies an opportunity to address a social problem through developing a franchising business model and enrolls independent franchisee-entrepreneurs to enter into an agreement to run individual business units according to the concept developed by the franchisor.

When a franchisee joins a social franchising network they benefit from the work that has gone into developing and refining the particular model as well as benefitting from being associated with a recognized brand, being able to source from an efficient supply chain benefiting from economies of scale, and potentially accessing training, finance and other support and professional services. For their part, franchisees are often required to adhere to quality and

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[1] Fairbourne, J. S., Gibson, S. W., & Dyer, W. G. (Eds.). (2007). *Microfranchising: Creating wealth at the bottom of the pyramid*. Edward Elgar Publishing; Kistruck, G. M., Webb, J. W., Sutter, C. J., & Ireland, R. D. (2011). Microfranchising in Base-of-the-Pyramid markets: Institutional challenges and adaptations to the franchise model. *Entrepreneurship Theory and Practice*, *35*(3), 503-531.

[2] Christensen, L. J., Parsons, H., & Fairbourne, J. (2010). Building entrepreneurship in subsistence markets: Microfranchising as an employment incubator. *Journal of Business Research*, *63*(6), 595-601; McKague, K., Menke, M., & Arasaratnam, A. (2014). Access Afya: Micro-clinic health franchise designed for scale. In *Social Franchising* (pp. 61-79). Palgrave Pivot, London.

customer service standards, share business information and generate a revenue stream for the parent franchisor through margins on products sold, fixed payments, or some combination of the two.

Based on our collective experience in studying, advising and creating social franchises in Kenya, Bangladesh, Zambia, Uganda, Mali and India,[3] we have found that, generally speaking, local franchisee-entrepreneurs can usually be supported to achieve business unit profitability (i.e. at the level of shop or clinic). In our experience, the biggest challenge by far that all social franchisees face across various sectors and countries, is finding a business model that can cover the overhead costs of the parent franchisor so that the network as a whole can break-even and scale. Many organizations that have established franchising models to address social needs are in the middle of this process of experimenting with, developing and validating their business model with this core challenge front of mind. One of the organizations experimenting with this central social franchising challenge is Farm Shop, a Kenyan agricultural inputs franchise.

Farm Shop was founded in 2012 by Ashoka Fellows Farouk Jiwa and Madison Ayer, to be smallholder farmers' partner in prosperity by providing inputs that increase farmers' productivity, incomes and food security. By early 2018, Farm Shop had grown to a network of 74 shops serving 30,000 smallholder farmers, 50 percent of whom are women. Farm Shop's vision was that if it could break-even and reach financial sustainability, it could scale to a network of hundreds and then thousands of shops in Kenya, East Africa and beyond.

With the core challenge of sustainability and scale in mind, in 2015, Farm Shop partnered with a team of specialist researchers and collaborators and received an implementation research grant by the International Development Research Centre and Global Affairs Canada under the Canadian International Food Security Research Fund (CIFSRF) Phase II, which aimed to "to scale up research results and innovations to reach more people and have a

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[3] See McKague, K., Wong, J., & Siddiquee, N. (2017). Social franchising as rural entrepreneurial ecosystem development: The Case of Krishi Utsho in Bangladesh. *The International Journal of Entrepreneurship and Innovation*, *18*(1), 47-56; McKague, K., Menke, M., & Arasaratnam, A. (2014). Access Afya: micro-clinic health franchise designed for scale. In *Social Franchising* (pp. 61-79). Palgrave UK; Jiwa, F. (2007). Honey Care Africa. *Microfranchising: Creating wealth at the bottom of the pyramid*, 149-163.

greater impact globally to improve food security."[4] An earlier Phase I round of grants had focused on incubating innovations to improve food security such as new vaccines, seeds, fortified foods, etc. Phase II shifted the emphasis to understanding how innovations can be scaled through private sector organizations like Farm Shop. The research project with Farm Shop was unique in CIFSRF's Phase II portfolio in that Farm Shop was a social franchise rather than a traditional development project, research center or non-governmental organization.

The original idea for Farm Shop emerged from Farouk and Madison's previous work together at Honey Care Africa, a social enterprise operating in Kenya, Tanzania and South Sudan which is now East Africa's largest producer of honey. When Honey Care Africa needed a business partner to distribute beehives and bee-keeping equipment to rural farmers in Kenya, they couldn't find any organization with a modern, efficient, coordinated distribution network to supply to smallholder farmers. Seeing this challenge and opportunity, the idea for Farm Shop was born.

A Social Franchising Model for Smallholder Farmers

Farm Shop's business model was being developed to help address the world's food security challenge where, globally, 795 million people are food insecure.[5] The World Bank's research has identified that if supported correctly, growth in the agricultural sector can be at least twice as effective at reducing food insecurity, alleviating poverty and improving the lives of smallholder farmers than growth in other sectors.[6] However, to be successful, agriculture-led growth requires a revolution in productivity and profitability in smallholder farming.[7] While green revolutions have more than doubled agricultural productivity in most of the world, Africa has shown very little relative improvement.[8] This stagnation in African agricultural productivity is due to many factors including the lack of access to productivity-enhancing inputs and knowledge in rural areas because of high transaction costs, limited infrastructure

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[4] CIFSRF Call for Proposals, February 2nd, 2015.
[5] FAO, 2015
[6] Curtis, 2010. Agricultural growth is at least twice as effective in reducing poverty as growth originating in other sectors. See Mondiale, B. (2008). *World Development report: agriculture for development*. Washington DC: The World Bank, page 6.
[7] Mondiale, B. (2008). *World Development report: agriculture for development*. Washington DC: The World Bank.
[8] BMGF cite.

and institutions and lack of economies of scale.[9] Perceiving these challenges, various donors have developed projects to support agricultural input shops, however these initiatives have not been financially sustainable or successful in achieving scale.[10]

In establishing Farm Shop, Farouk and Madison were conscious of the strengths and weaknesses in the institutional environment in Kenya. Their target market – smallholder farmers – were poor, geographically disbursed and risk-averse with low levels of literacy and cognitive bandwidth.[11] Women farmers faced additional constraints such as more limited access to credit and greater household workloads and responsibilities.[12] An additional challenge was that crops and livestock varied from region to region due to agro-ecological soil and climate conditions as well as local factors like proximity to markets. Local entrepreneurs that could become franchisees often had limited business skills and discipline around reinvesting profits from sales back into inventory. The value chain from formal sector suppliers of agricultural inputs such as feed, seed, fertilizers, medicines, etc. to independent shops was fragmented with limited economies of scale and uncertain levels of product quality and reliability.

It was to remove obstacles and reduce risks for farmer and franchisee success that Farm Shop developed its social franchising business model. Like other social franchises, the key challenge to scale would be to develop a business model that would generate enough income to cover the overhead costs of the parent franchise organization. Farm Shop generates revenue on the margins it earns between purchasing agricultural inputs from suppliers and selling them to franchisees (see figure 1). Farm Shop sells about 700 SKUs in eight major product categories: animal feeds, veterinary medicines, minerals, day-old chicks, seeds, fertilizers, agrochemicals,

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[9] Mondiale, B. (2008). *World Development report: agriculture for development*. Washington DC: The World Bank, page 12.

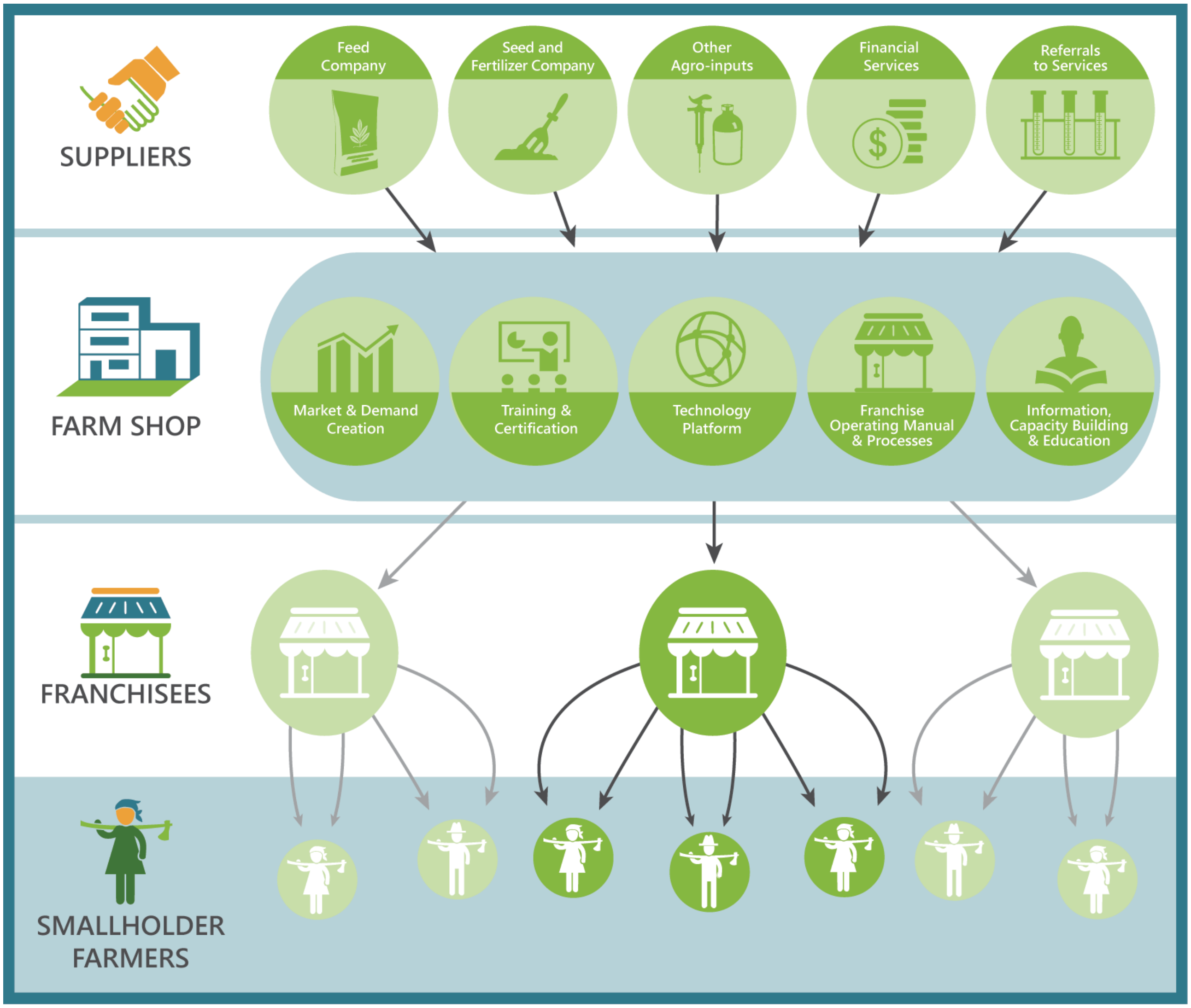
[10] See, for example, "The ADAPT Project in Zambia: Successes and Lessons in Building a Scalable Network of Rural Agro-Dealers to Serve Smallholders" (2010). Atlanta: CARE USA. Farm Shop board members Farouk Jiwa and Christian Pennotti served as advisors to this initiative which received funding from the Rockefeller Foundation and AGRA (Alliance for a Green Revolution in Africa).

[11] ACUMEN and Bain and Company. (2014). Growing Prosperity: Developing Repeatable Models. Available at: http://acumen.org/growing-prosperity/; HYSTRA Hybrid Strategies Consulting (2015). *Smallholder farmers and business: 15 pioneering collaborations for improved productivity and sustainability*

[12] McKague, K., (2014). Gender. In McKague, K. & Siddiquee, M. *Making Markets More Inclusive.* New York: Palgrave.

and equipment. They also refer farmers to a variety of services including veterinary services, artificial insemination, and soil testing.

Figure 1: Farm Shop's Social Franchise Business Model



In the blueprint stages of business model development before it opened its first shop, Farm Shop drew on research and the founders' experience in several countries to estimate that, with some small but critical improvements in the existing supply chain, an average shop might sell US$5,000 per month with a 10% margin retained by Farm Shop. With headquarters overheads at roughly US$1M annually, initial estimates were that the network could break-even at around 150 shops.

Farm Shop's approach was primarily a conversion-franchising model where existing independent agro-dealer shops would be converted into Farm Shop branded shops. In Kenya, the norm is for existing agro dealer shops to be operated behind metal bars where customers can't browse products, see prices or choose between various product offerings. As a result, a sense of distrust between farmers and shop owners is generated. Farmers can't tell by looking if feeds have fillers, if seeds will germinate into the varieties promised or if animal medicines are legitimate. Because of these constraints smallholder farmers face, including their vulnerability to the climate and inability to reverse purchasing decisions, building trust with farmers was essential to Farm Shop's social franchising model. One way this was achieved was a dramatically different shop format and relationship between farmer-customers and franchisee business owners. Premises were open to allow product inspection and comparison, prices were clearly labeled on all products, and shop owners were trained to provide information to farmers on selecting products that would best meet their particular needs. All products were sourced through reputable suppliers to guarantee quality and authenticity and shop owners and their shop assistants received training in customers care, agricultural practices and animal husbandry so they could help farmers make the best choices for their livelihoods.

In 2012, Farm Shop converted its first independent agrodealers to Farm Shops with cofounder Farouk Jiwa using his apartment as the organizations first temporary inventory warehouse. Farm Shop more or less doubled its number of shops every year in its early years, with 12 shops in 2014 and 25 in 2015 and 48 in 2016. As Farm Shop grew, increasing evidence was accumulating that the open shop format, quality products, informative and helpful service model introduced by Farm Shop was benefitting farmers as well as the broader rural entrepreneurial ecosystem. For example, other local agro-dealer shops began to copy the open shop format and layout of Farm Shops. As the highest form of recognition of Farm Shop's achievement, a competitor entered the market to start a similar franchise network.

As Farm Shop grew quickly and expanded under the support of the CIFSRF implementation research project, it worked overtime to develop information systems that could test the fundamental financial assumptions on which the scalability of its model was based.

Developing the accounting, inventory and point-of-sale systems was a challenge in itself as the pieces were costly and complex to integrate with few local suppliers able to provide a comprehensive solution. However, when data began coming in, it revealed several issues with the business model that would need to be urgently addressed if Farm Shop was to stay on a trajectory toward breakeven and scale:

- **Margins:** Farm Shop discovered that selling agricultural inputs to smallholder farmers is a much lower margin business than anticipated with average margins of 5 per cent on sales over all products. Animal feed, which made up 75 per cent of Farm Shop's sales, had particularly low margins, at about 3.5 per cent. Suppliers were less willing than expected to give discounts even at the volume of demand generated by 74 shops. The existing network of relationships between suppliers, distributors, wholesalers, sub-distributors was more complex and difficult to disrupt than Farm Shop had anticipated.

- **Overheads:** Looking at the numbers, Farm Shop found that overheads were higher than expected due to the startup nature of the organization and the commitment to many direct social impact activities like farmer training.

- **Franchisee Profitability**: Farm Shop also found that fewer of its franchisees were as profitable as anticipated. In some cases, opening new shops were costing Farm Shop more than were generating in sales margins once the indirect costs of marketing and support were factored in. Supporting all franchisees required much more Farm Shop staff time than expected and despite this, the franchise failure rate remained stubbornly high at 10% annually.

The data coming in based on Farm Shop's accounting and inventory management systems were unequivocal. Without any changes, Farm Shop would not break even and could not scale. Farouk, Madison and their senior management team therefore reacted with a series of strategies to increase revenues and reduce costs to get the organization back on a trajectory toward breakeven and scale.

Increasing Revenues

- **More margins from existing products.** Farm Shop needed to increase its margins. One strategy Farm Shop developed included selling more high-margin products, for example hay (25% margin) and maize bran (10% margin). They updated their information system to track and regularly report on sales margins for various product categories and assigned managers targets for increasing average margins on different types of products.

- **New revenue streams**. Farm Shop also began to explore new lines of business that would generate additional revenue streams. As an example of this, day-old chicks were added to Farm Shop's offerings and they began scanning the environment for other opportunities.

- **More company-owned stores.** Farm Shop's original business concept was to have franchisees own all shops. However, after a few franchisees failed to operate successful businesses in otherwise promising locations, Farm Shop took over the ownership and management of six of these shops and found that average margins it could earn were about 6% higher than in franchisee owned shops. Farm Shop began to look more closely at how they could increase the number of company-owned shops to boost their profitability.

- **Support shop success.** Given the mixed success of initial franchisees, Farm Shop developed a system to evaluate the quality of its shop owners and rank them into "gold", "silver" and "bronze" categories according to their performance. "Gold" franchisees were rewarded with greater eligibility to access financing and participate in pilot projects testing new ideas. "Silver" and "bronze" franchisees were supported with targeted interventions wherever possible to address weaknesses and optimize business profitability.

Reducing Costs

- **Separate for-profit and not-for-profit activities.** A main strategy to reduce Farm Shop's business operating costs was for Farm Shop to separate activities into those managed by Farm Shop retail (a for-profit organization) and those managed by Farm Shop NGO (a separate not-for-profit organization). By separating activities between the two organizational entities, Farm Shop aims to reduce the costs to Farm Shop retail of the farmer training, research and development, and impact measurement functions, which will be funded through Farm Shop NGO.

- **Optimize supply chain efficiencies.** Farm Shop brought forward a number of strategies to reduce costs through achieving greater efficiencies in its supply chain from suppliers to franchisees. Importantly, Farm Shop hired an experienced new CEO with a background in distribution, supply chain and logistics management with a mandate to bring Farm Shop in line with best practices in retail franchise operations. Activities being implemented include optimizing warehouse space and truck delivery routes, increasing direct purchasing from manufacturers (rather than wholesalers) and continually assessing market prices to ensure competitiveness while working towards reducing costs and increasing product margins.

- **Close unprofitable shops.** Although many Farm Shop franchisees were profitable, a number have struggled, despite training and consistent hands-on support from Farm Shop staff. One of the most significant problems is when franchisees find themselves unable to reinvest profits into inventory, leading to a downward spiral in product availability, customer satisfaction and profitability. Closing the shops that are unprofitable, despite best efforts, is reducing the drain on Farm Shops resources and allows staff to support the more successful shops which create a virtuous cycle of income generation and serving smallholder farmers with the inputs and information they need.

After several months of putting its new strategies in place to reduce costs and increase revenues, Farouk, Madison and the research team recalculated Farm Shop's trajectory with the help of a specially tailored financial model. Based on a number of assumptions about how the future will unfold, projections are that Farm Shop should now be able to break even at about 500 shops. Given its intensive journey on the path to scale so far, dealing with the issues so central to the success of all social franchises, Farm Shop has identified two overarching lessons learned for scaling a social franchise.

Lesson 1: A business model needs to be developed and validated before being scaled. If each new shop opened costs the franchising network more than it generates, the system will scale itself out of business. Social franchises like Farm Shop operate in contexts with a lot of uncertainty – uncertainty about farmer, franchisee, supplier and competitor behaviour and preferences. In the early stages of launching and building a new venture, many assumptions act as placeholders until they can be validated. The path to scale can be seen as a continual process of making assumptions and learning whether they are true or not and continually adjusting based on feedback and data from experience in the market. As a Farm Shop board member stated, "One of the things we have been promoting at Farm Shop is that all staff understand that we're on a journey, we're discovering new things, that we don't know the answers." Fundamentally, before an organization can scale, it needs to validate the financial assumptions underlying its business model and establish a clear path to profitability and scale.

Lesson 2: To develop a scalable business model, cost effectively gathering the right data to validate key assumptions is essential.

Data collection and management systems are essential to achieving scale as they need to be used to gather the information that will test financial assumptions and validate elements of the business model. One of Farm Shop's lessons is that organizations in the early stage of development face challenging choices with respect to designing and investing in data systems. A first challenge is that developing these information systems are costly in terms of time and money. The second challenge is that in the early stages of business model development and iteration its not always clear what the most important data points are to measure. As a board member explained, "We need the data systems and IT systems in place to source relatively accurate data. We were making a lot of assumptions based on imperfect data. To some degree that's fine – most start-ups and growing organizations have an issue with imperfect data because it costs an extraordinary amount to get perfect data. As you grow and evolve – the other problem is – you're not even sure what data you need. A lot of the underlying numbers, we didn't realize we needed these, or that these were critical numbers; we had to fundamentally change them over time as we analyzed which data points were really critical and which were not." Without accurate and timely data, the fundamentals of the business model cannot be tested and validated, which is an essential step on the path to scale.

Conclusion

Farm Shop is one of the cohort of pioneering social franchises that have applied the principles of franchising to address a particular social need – in this case, the prosperity, food security and livelihoods of smallholder farmers. Like others experimenting with social franchising, Farm Shop has faced the hard work of developing a business model that could generate sufficient revenues to cover overhead costs and allow the network to break even and scale through market forces. On this journey, Farm Shop uncovered important lessons relevant for all social franchises at similar stages in the business model development process: make sure your financial model has been validated before embarking on scale, and do everything possible to gather the business and financial data you need to test the model. With these lessons in mind, Farm Shop and other social franchises can be even better equipped to live up to social franchising's promise of achieving social objectives in a more resource efficient and sustainable way.