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**COLOMBIA**

**DEVELOPING BUSINESS FORMAT MICRO-FRANCHISING MODELS FOR LOW  
INCOME POPULATIONS**

**(CO-M1082)**

**DONORS MEMORANDUM**

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## PROJECT SUMMARY

### DEVELOPING BUSINESS FORMAT MICRO-FRANCHISING MODELS FOR LOW INCOME POPULATIONS

#### (CO-M1082)

Franchising is widely recognized as one of the most effective mechanisms for rapidly scaling a business by a cost-efficient and low risk method of growth to franchisors, while offering incentives for franchisees. “Micro”-franchising is a business and social development strategy being increasingly adopted in emerging markets; if applied correctly, it can be a win-win for businesses who want to scale and for low-income people who seek low risk solutions to generate sustainable income, even with low capital, little education or business experience. Recently a number of Impact Investors have seen micro-franchising as a potential addition to their portfolio as it may lower risk and create jobs. However, today in Colombia, an increasing number of private and public institutions are applying the concept of micro-franchising and its emerging methodologies to very different purposes, which is resulting in confused policy debates.

The proposed project will contribute to closing the current knowledge gap surrounding micro-franchise – particularly of “business format” micro-franchise.<sup>1</sup> This will be achieved by identifying franchisors interested in: (i) implementing micro-franchising to serve the poor and lower income populations; (ii) building capacity for potential micro-franchisees; and (iii) capturing the knowledge to maximize the balanced benefits in both economic and social impacts through franchise businesses. In view of the complexities of those inter-related issues - low awareness of micro-franchising, risk-averseness among entrepreneurs, the need for capacity-building for micro-franchisees, and the scarcity of finance, the project will focus on developing a marketplace for micro-franchising in the form of an hub/platform to support franchisors and micro-franchisees by aligning the incentives of both parties. Moreover, given high interests from many supporting institutions, the platform will serve as an effective way to consolidate the current efforts, and accelerate the development of this nascent industry. The project will complement the “Regional Facility for Promoting the Economic Empowerment of Low Income Populations through Microenterprise Distribution Networks” (RG-M1234), which is currently in execution, as the Facility focuses on “distribution franchising”, and its regional resource center is expected to be further strengthened by the knowledge products generated by the proposed project.

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<sup>1</sup> There are two main methods of franchising: (i) **distribution franchising**; and (ii) **business format franchising**. The former is the process of using the name of the franchisor to deliver products and services to customers for a prescribed location and time. The latter is where the franchisor develops a **brand and operating system** for the business and licenses that to the franchisee who then delivers products and services using the name and operating system of the franchisor.

## **ANNEXES**

ANNEX I	Logical Framework
ANNEX II	Budget Summary
ANNEX III	Quality for Effectiveness in Development (QED)

## **APPENDIXES**

Draft Resolution

## **INFORMATION AVAILABLE IN THE TECHNICAL DOCUMENTS SECTION OF MIF PROJECT INFORMATION SYSTEM**

ANNEX IV	Detailed Budget
ANNEX V	Preliminary List of Milestones
ANNEX VI	Diagnostic of Needs of the Executing Agency (DNA)
ANNEX VII	Execution Unit and Reporting Requirements
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ANNEX X	Project Activities Schedule
ANNEX XI	Operating Regulations
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## **ACRONYMS AND ABBREVIATIONS**

<b>ACOPI</b>	Colombian Association of Small and Medium-sized Industries
<b>ANSPE</b>	Colombian Government's Agency for Overcoming Extreme Poverty
<b>CRF</b>	Corporate Results Framework
<b>DNA</b>	Diagnostic of Executing Agency Needs
<b>DNP</b>	National Department of Planning
<b>DPS</b>	Department for Social Prosperity
<b>GEM</b>	Global Entrepreneurship Monitor
<b>ICONTEC</b>	Instituto Colombiano de Normas Técnicas y Certificación (Colombian Institute of Technical Standards and Certification)
<b>IDB</b>	Inter-American Development Bank
<b>IFA</b>	International Franchise Association
<b>LAC</b>	Latin America and the Caribbean
<b>MCIT</b>	Ministry of Commerce, Industry and Tourism
<b>MFI</b>	Microfinance Institutions
<b>MIF</b>	Multilateral Investment Fund
<b>MSME</b>	Micro, Small and Medium-sized Enterprise
<b>OMJ</b>	Opportunities for the Majority
<b>PEU</b>	Project Execution Unit
<b>PROPAIS</b>	La Corporación para el Desarrollo de las Microempresas
<b>QED</b>	Quality for Effectiveness in Development
<b>SCF</b>	Structured Corporate Finance
<b>SENA</b>	National Service for Learning
<b>SME</b>	Small and Medium-sized Enterprise

PROJECT INFORMATION

DEVELOPING BUSINESS FORMAT MICRO-FRANCHISING MODELS FOR LOW INCOME POPULATIONS  
(CO-M1082)

<b>Country and Geographic Location:</b>	Colombia		
<b>Executing Agency:</b>	La Corporación para el Desarrollo de las Microempresas (PROPAIS)		
<b>Access Area:</b>	Access to Markets and Skills		
<b>Agenda:</b>	Linking Small Firms to Value Chains		
<b>Coordination with Other Donors/Bank Operations:</b>	The project is being coordinated with SCF and OMJ as they are seeking to partner with large Colombian firms interested in micro-franchising models.		
<b>Direct Beneficiaries:</b>	The project's beneficiaries are 400 low-income owners/employees of 200 micro-businesses (micro-franchisees) and 20 small and medium-sized growing businesses as franchisors.		
<b>Indirect Beneficiaries:</b>	Indirect beneficiaries include 20 public and private organizations that offer micro-franchise services to microbusinesses, and 6,000 members of the beneficiary micro-franchisees' households.		
<b>Financing:</b>	Technical Cooperation:	US\$ 1,332,000	51% <sup>2</sup>
	Counterpart:	US\$ 1,208,150	49%
	<b>TOTAL PROJECT BUDGET:</b>	US\$ 2,540,150	100%
<b>Execution and Disbursement Period:</b>	42 months of execution and 48 months of disbursement.		
<b>Special Contractual Conditions:</b>	Conditions prior to first disbursement will be the selection of the Project Director.		
<b>Environmental and Social Impact Review:</b>	This operation was screened on March 22, 2014 and classified as required by the IDB's safeguard policy (OP-703). Given the limited impacts and risks, the proposed category for the project is C.		
<b>Unit with Disbursement Responsibility:</b>	MIF/CCO will supervise the project.		

<sup>2</sup> This percentage excludes the Impact Evaluation Account and Agenda Account.

## **1. BACKGROUND AND JUSTIFICATION**

### **A. Diagnosis of the Problem to be addressed by the Project**

- 1.1. The percentage of the Colombian population living below the national poverty line is 34%. Adding to this burden, because there is a 10% general unemployment rate and almost 25% youth unemployment rate, many Colombians will have no other choice but to be self-employed. One of the findings of the Global Entrepreneurship Monitor (GEM) is that innovation does not figure within the entrepreneurial landscape of Colombia, thus a majority of new businesses are unable to go beyond a subsistence level. Recent study of the World Bank<sup>3</sup> confirms such scarcity of innovation. This risk of being stuck to subsistence level entrepreneurship becomes critical in case of vulnerable and low-income populations; if the business goes wrong, it cannot only lose their investment, but fall swiftly under the poverty line. Therefore, the main problem that the project will attempt to solve is subsistence level of micro-enterprises, which should be addressed by helping develop growing businesses.
- 1.2. La Corporación para el Desarrollo de las Microempresas (PROPAIS) in Colombia conducted an extensive survey in 2012 in three main regions- Bogotá, Cali and Medellín, and found out that there exists a clear demand for a lower-risk form of entrepreneurship, as well as an effective method for growing a business for owners, confirming the emerging recognition of micro-franchising as a tool to address the above-mentioned problem.<sup>4</sup> The foundation of micro-franchising is squarely based on traditional franchising involving: (i) the franchisor who lends his trademark or trade name and a business system; and (ii) the franchisee who pays a royalty (and often an initial fee) for the right to do business under the franchisor's name and system - a system sustained by mutually compatible value propositions: (a) the security of a proven business model, training and support, as well as brand/marketing power, in exchange for which some of his or her independence is given up to comply with the established processes and procedures; and (b) the maintenance of the business system by continually investing in the value of trade name. However, franchising is not for everyone, nor all business models are “franchiseable.” In fact, while franchise systems have been identified in around 80 industries, about 50% of them are concentrated in only ten industries; the International Franchise Association (IFA) reports that 18% of all franchise systems are fast food while 11% are retail. Furthermore, some well-known American brands like Starbucks, Red Lobster and Olive Garden do not franchise, as they have opted to grow through their own subsidiaries instead.
- 1.3. As for the potential utility of micro-franchising for the vulnerable and low-income populations, although there is great interest among civil society organizations and government agencies, there is no consensus about what micro-franchising is or what role it could play as a development tool. As there is still no codification of franchising in

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<sup>3</sup> Latin American Entrepreneurs: Many firms but Little Innovation. World Bank, 2012

<sup>4</sup> M. Sabino, “The diagnostic study of the micro-franchising environment in Colombia”, 2013

Colombian law, deeper understanding of the meaning – beyond examples like McDonalds – is still rare among business owners and the population at large.<sup>5</sup> Even though high-profile examples of successful franchises are found, franchises are not always appropriate or viable; a large proportion of new franchisors fail. It is estimated that of the new franchise systems created in the US each year, 25% cease to exist in less than a year and 40% fail within its fourth year.<sup>6</sup>

- 1.4. However, the current empowerment programs through micro-franchising focus disproportionately on their potential benefits for the low-income population, while they may gloss over the real business risks involved in franchise operations. Furthermore, in the disproportionate focus on aiding the low-income populations, the needs of the franchisors are not being adequately addressed, putting strain on their business model and its entire business sustainability. While the benefits of the franchisor's network and business acumen can be a powerful tool in helping empower micro-franchisees<sup>7</sup>, franchising is still in its early stages and micro-franchising is even more recent in Colombia. Thus, many micro-entrepreneurs do not appropriately allocate limited resources where micro-franchise is viable or conversely enters into franchises without a solid rationale. On the other hand, while supplying 'business-in-a-box' (i.e. proven business method) plus ongoing branded products, franchisors are often unable to control site selection, pricing, sales territories, hours of operation, etc. This ironically forces some potential franchisors to become too cautious about engaging in micro-franchising.
- 1.5. **Causes:** It has been argued that a structural barrier for the progress of low-income people is their networks – they remain poor because they have "poor" networks. In their community, the poor may not have the access to suppliers, service providers, partners, brand-builders, and customers. In addition to that, not everyone is apt for becoming an entrepreneur, thus, the poor and low-income populations need to be forcefully "creative", which constitutes "entrepreneurial burden".
- 1.6. Secondly, the vulnerable and low-income people tend to have inadequate access to skill-up trainings; they also tend to have lower levels of general business experience and run informal businesses. Because of this lack of education and experience, micro-franchisee requires a significant amount of support from the franchisors. Although the franchise model allows the franchisor to grow without much overhead investment and compliance mechanisms that more tightly controlled networks call for, counterfeit (stealing proprietary business brands/business models) would be a particular downside in economies that have such a large informal sector as Colombia does. Finally, as is the

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<sup>5</sup> The US is the undisputed leader in franchising across the world. In 1979, the U.S. Federal Trade Commission created the Trade Regulation Rule on Franchising, which made it a requirement for the franchisor to create a disclosure document that covers all continuing commercial relationships, setting out clear descriptions for franchising as well as for the roles of the franchisor and the franchisee.

<sup>6</sup> Shane, "From, Ice Cream to the Internet: Using Franchising to Drive the Growth and Profits of Your Company".

<sup>7</sup> Lehr, "Microfranchising at the Base of the Pyramid". Acumen Fund, August, 2008



case with any start-up, the options for financing are limited. With track records of a few years of operations, franchisors around the world recognize that they have to go beyond their core competency to provide financing or serve as guarantors. In Colombia, this is a serious problem; Potential franchisors do not wish to move out of their core competency, or simply do not want to take on the additional risk of offering funds or guarantees, while micro-franchisees are unable to obtain enough credit.

1.7. **Knowledge Gap.** Micro-franchising, if applied correctly, can be a win-win for businesses who want to scale and for low-income people who seek low risk solutions to generate sustainable income, even with low capital, little education or business experience. In order to define the current knowledge gap, it is important to unpack several concepts including what “micro” refers to and what “franchising” means, and how key elements of traditional franchise can be applicable to micro-franchise.

- (i) What is the lower limit for micro-franchise? “Micro” generally refers to low cost investment and low-income micro-franchisees. However, the size of the required investment, as well as the profile of a potential micro-franchisee (generally poor and low-income population), are unknown.<sup>8</sup> It would also be useful to check the concept’s validity for micro businesses against the key successful feature of traditional franchising such as: (a) the necessity of a physical area to serve customers; (b) the importance of a brand name value in the market; (c) the ease of standardization and replication of the model; (d) the need for a labor-intensive model; and (e) relatively low-risk and low cost outlets.
- (ii) How much support do franchisors need to provide for micro-franchisees? The franchisor trains the franchisees, gives them use of the brand, and provides direct links to its supply chain. By buying into a proven, systematized business model, along with the franchisor’s networks, sales/marketing channels and knowledge, the risks for the micro-entrepreneur are reduced, while he/she is protected from market fluctuations. However, several anecdotes demonstrate that franchisors in micro-franchises often have to get involved much beyond the levels of a traditional franchise, including provision of basic business training - apart from the specific training needed to be part of a franchise system.
- (iii) To what extent is the promotion of “business format” franchise viable for micro-franchising? The micro-franchising projects so far are concentrated in “distribution (product) franchise” (e.g. Coca-Cola) rather than “business format franchising” (e.g. Subway). In the business format franchise, uniformity and quality in the operating system is critical. There should be a contractual limit regulating discretion of resources with which the franchisee has the right to operate. This limit (or some discretion) could weaken (or further strengthen) some of the key elements that

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<sup>8</sup> While “micro” can describe the customers’ low purchasing power that can buy the products or services being sold from the micro-franchisee, some product and service franchises can often serve several levels of the pyramid, not just the poor and low income populations.

make traditional franchise successful, such as: (a) the need for high local market knowledge; and (b) the need for production and distribution limited to a small geographic location. It is thus important to examine how compatible the principles of franchising (particularly business format franchising) can be with a development strategy geared towards utilizing the competitive advantages of franchisees such as local community knowledge.<sup>9</sup>

## **B. Project Beneficiaries**

- 1.8. The project is directed towards 200 micro-enterprises committed to starting a new franchised business that would generate a total of 400 new jobs (200 micro-enterprise owners and 200 employees of the micro-franchisees). These 200 micro-enterprises are connected to 20 franchisors<sup>10</sup>. It is important to note that these franchisors are most likely to be growing small/medium-sized firms, having at least two years of operation; unlike the micro-franchising projects previously financed by the MIF, under the proposed business format micro-franchise project, the franchisors are one of the main project beneficiaries as opposed to the so-called anchor firms. The project will mainly target four geographic areas that include the regions of Bogotá, Cali and Medellín; the fourth target region will be either Barranquilla or Coffee Growers Region- which will be decided at the beginning of the project implementation based on the market analysis and validation to be done as part of the project's component.

## **C. Contribution to MIF Mandate, Access Framework and IDB Strategy**

- 1.9. This project will help achieve the MIF's mandate to reduce poverty by creating new businesses for low-income populations by linking them to value chains. The project contributes to the "Linking Small Firms with Value Chains" Agenda. The project will also further the 2012-2014 IDB Country Strategy for Colombia in the areas of expanding services to the private sector, promoting growth and competitiveness and, especially, supporting equality of opportunity by addressing barriers to growth for micro and new businesses owned by the low-income populations. The other private sector windows of the Bank including the Opportunities for the Majority (OMJ) and Structured Corporate Finance (SCF) may be able to develop loans for potential franchisor firms of the

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<sup>9</sup> There are three key performance drivers identified associated with business format franchising: overcoming agency concerns, reducing resource scarcity and leveraging brands/standardized operations. Theory suggests that the traditional franchising model aligns agent-principal interests by using franchisees that have a vested interest in their unit's performance versus internal managers in company-owned stores who need to be incentivized. Franchising is also thought to enable the franchisor to reduce resource scarcity by sharing start-up and operational costs with franchisees. Leveraging standardized operations across the chain is expected to allow the franchise to take advantage of proven business format and a common brand decreases customers' uncertainty about what to expect. Recent research shows that these traditional drivers, when applied to micro-franchising, are not functioning well due to several aspects of the low income populations' market context (Kistruck, Webb, Sutter and Ireland, *"Micro-franchising in Base-of-the Pyramid Markets: Institutional Challenges and Adaptations to the Franchise Model"*).

<sup>10</sup> Each of 20 micro-franchisors is expected to develop an estimated average of 10 micro-franchisees, and each micro-franchisee is expected to generate one employee.

proposed MIF project. This coordination is expected to help scale the project results and sustain them in the long-term.

## **2. PROJECT DESCRIPTION**

### **A. Objectives**

- 2.1. The project's objective at the impact level is to contribute to generating sustainable income for the vulnerable and low-income populations in Colombia through the micro-franchise business growth. The objective at the result level is to help micro and small businesses scale effectively through the design and implementation of business format micro-franchise model. The project, developing a marketplace, will address the knowledge gap surrounding the micro-franchise concept (See Paragraph 1.7).
- 2.2. This project will complement the regional program in execution "Regional Facility for Promoting the Economic Empowerment of Low Income Populations through Microenterprise Distribution Networks"(RG-M1234); the Facility focuses on "distribution franchise", while the proposed project will focus on "business format franchise". It is important to note that the franchisors to be targeted in this project will include those growing small/mediums-sized enterprises that would be interested in adopting micro-franchising as a strategy for business expansion and scale-ups, and that the project's emphasis is to create knowledge products that can fill the current gap such as common definition for micro-franchising, thus making business operations easier to start, scale and sustain both for franchisors and franchisees.

### **B. Description of Model/Solution/Intervention**

- 2.3. Given the newness of the concept in Colombia, and considering the lack of a legal framework, deficient capacity among entrepreneurs, and insufficient financing, the project will:
  - (i) Promote awareness around the concept of micro-franchising, developing a consensus among a wide range of the stakeholders on the meaning of micro-franchising with a more nuanced understanding of what types of businesses can and should franchise;
  - (ii) Build capacity for both franchisors and micro-franchisees by offering training (management, market analysis, processes and procedures in setting up or buying a franchise, resource planning, innovation, etc.) and certification options to assure quality and reduce information asymmetry. The increased credibility conferred on the parties as a result of certification could play a significant role in facilitating the process as well as making it more efficient;
  - (iii) Provide business mentoring through a network of mentors (those who have successfully franchised) for selected micro-franchises, once the businesses are

under operation, whereby the new franchising companies could be paired with them, offering a learning opportunity;

- (iv) Develop a transparent clearinghouse/marketplace bringing potential franchisors and potential micro-franchisees together so that they may enter into business with one another. This platform will offer the following specific services: (a) opportunity identification to distill business ideas emerging in the current markets; (b) online portal that provides a searchable database of information on micro-franchising (market analysis, franchising processes and procedures), entrepreneurs certified under the process established (see above (ii)), and basic advices on legal, accounting, financing and tax, etc.; (c) tools for micro-franchise development including diagnostic tests to assess capabilities and evaluate their business health, and monitoring tool to assess their progress and compare themselves to similar businesses in the database; (d) business roundtables organized as meet-ups of both parties who have advanced in the business development, and are looking to close the deal; and (e) facilitation of financing for micro-franchising to connect with all the possible channels of financing for both franchisors and micro-franchisees, including campaigns to reach financial partners, and development of new financial products such as guarantees or micro-leasing;
- (v) Develop knowledge products that can fill the existing gap though: (a) research to identify good practices and benchmarks of micro-franchising across the world as well as in Colombia, analyzing future and current trends on efficiency, innovation and scaling, and local context of commercialization; and (b) development of methodologies to serve as an integrated home grown micro-franchising methodology (in particular for business format micro-franchising) that will be uploaded and updated on the on-line portal above-described.

- 2.4. A vehicle like the platform described above is expected to create a community of business owners who desire to scale up their enterprises, as well as low-income people who would like to become low-risk entrepreneurs. Apart from those interested in buying or selling micro-franchises, the marketplace will be useful for the general community that can interact with a variety of stakeholders. Besides, it will harness the franchisors' access to the network of the vulnerable and low income populations, which should help it achieve economies of scale. It will also help construct a database hosting micro-franchises that passed through a qualification process; disclosed information of which will allow for the efficient business transactions, increasing the credibility of the model as a whole. Moreover, the marketplace will serve as a forum to attract potential financial and in-kind partners to support initiatives.

## C. Components

### **Component I: Awareness and Fomenting Actions (MIF: US\$95,000; Counterpart: US\$144,950).**

- 2.5. The activities of this component will include the organization of events to disseminate key information on the micro-franchising concept and good practices. In particular the objective is to help understand: (1) what kind of processes and procedures are necessary to franchise a business; (2) what skills are necessary for successful micro-franchise entrepreneurs; and (3) what franchising entails in practice (for franchisors and micro-franchisees). The activities will be carried out in three major cities and one additional region (Bogotá, Cali, Medellín, and Barranquilla or Coffee Growers Region), and will include: (i) consultancy for developing the “unified definition” of the micro-franchise concept and its essential elements including processes, procedures, contents and strategies; (ii) awareness workshops both for franchisors and micro-franchisees; (iii) development and implementation of communications strategies including the program’s logo, web page development, brochures and other materials for promotion and dissemination; (iv) developing partnerships among private and public entities in four respective regions aiming at extracting support for the project’s dissemination and logistics contribution for workshops and other activities; and (v) a launching event intended to make the project known to a broader audience.
- 2.6. The expected results are: (i) a fundamental concept developed and widely agreed on micro-franchise; (ii) 100 potential micro-franchisors sensitized; (iii) 1,000 potential micro-franchisees sensitized; (iv) 40 potential public-private partners sensitized; and (v) 20 partner agreements formalized.

### **Component II: Capacity Building for Micro-franchises (MIF:US\$182,000; Counterpart:US\$408,200).**

- 2.7. In building capacity for both franchisors and micro-franchisees with an emphasis on the latter, the activities under this component constitute training and certification options for both groups. The key disciplines include general business training as well as market analysis for specific targets. Other topics include the processes and procedures in setting up or buying a franchise, resource planning, product/service innovation, and relevant legislation. In order to follow up with the initial training, business mentoring for selected franchising systems will be provided. More concretely, the activities contemplated include:
- (i) Formation of alliances. The 20 public and private partner institutions identified under the Component I (see Paragraph 2.6) will receive training about their involvement in the project, which will be carried out in the four different cities/regions.

- (ii) Training of trainers. The trainers will receive training through in person and virtual methods; once trained, the trainers will train potential franchisors as well as micro-franchisees in finance, legal, marketing and organizational aspects. Key representatives from potential partner organizations will be trained as well.
- (iii) Technical assistance for start-ups and early stage business expansion. This activity will be divided into two parts: (a) business advisory services for potential franchisors; and (b) business advisory services for potential micro-franchisees; both will examine all the key aspects of business start-ups and business expansion in their early stage.
- (iv) Development of franchise certification protocol. In order to assure quality and reduce information asymmetry, certification protocols will be developed for both micro-franchisors and micro-franchisees, whose criteria for certification will be designed under this Component. It is expected that the project would partner with an internationally –recognized certifying body such as ICONTEC<sup>11</sup> in the future, but during the life of this project there would be no need for complex protocols; it would rather elaborate basic protocols that would be applicable to a limited number of the parties involved – which would have to be carefully chosen – as they would contribute to laying the groundwork for more sophisticated works to be undertaken by the institutions such as ICONTEC.
- (v) Specific technical assistance for implementing micro-franchise models in accordance with the established protocols, addressing the issues identified in the process of certification so that they can comply with the standards. In principle the project resources will finance up to 50% of the costs incurred in implementing the model to help micro-franchisees as long as the franchisors belong to the category of SMEs defined in terms of their annual sales (up to US\$ 5 million) and number of employees (up to 200 employees). A majority of the franchisors are expected to be small and medium-sized growing businesses, two-thirds of which would be fully certified by the above-described protocol.
- (vi) Business mentorship. Other than the mentioned business advisory services, questions may arise regarding the process of operating a franchise, which can be effectively solved through peer-learning opportunities. For this purpose, a business mentorship network will be set up. The recently established National Association of Franchise in Colombia would be a good source of recruiting the mentors. In

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<sup>11</sup> Instituto Colombiano de Normas Técnicas y Certificación (ICONTEC). Colombian Institute of Technical Standards and Certification is a Bogota-based non-profit private Colombian organization that oversees the compliance of national and international standards. It is an open organization with members from the Colombian government, private sector and in general any individual who might be interested in the compliance of standards in Colombia. ICONTEC works closely with other international organizations for standardization. ICONTEC accredits organizations, companies and individuals that engage in the manufacturing or development of products and industrial processes. It is a member of the International Organization for Standardization (ISO) and is an active partner in regional standards organizations such as COPANT and IEC. ICONTEC is present in different countries of the Americas and the Caribbean.

addition, franchising companies could be paired with companies who have successfully franchised in other sectors, offering a learning opportunity.

- 2.8. The expected results are: (i) 30 trainers trained with strengthened capability to master the micro-franchise model; (ii) 40 representatives from 20 public and private partner organizations trained; (iii) 60 potential micro-franchisors located in 4 different regions trained in business administration and market analysis; (iv) 600 potential micro-franchisees trained in business administration and market analysis; (v) two protocols developed for certification – for franchisor and micro-franchisee; (vi) 200 potential franchisees certified; (vii) 30 small and medium-sized enterprises as micro-franchisors received advisory services to ensure the micro-franchise implementation; (viii) 20 franchisors (out of 30 under (vii)) certified by the project; and (ix) a network of mentors established.

**Component III: Development of Micro-franchise Marketplace. (MIF:US\$410,000; Counterpart: US\$227,000).**

- 2.9. In order to bring potential franchisors and potential micro-franchisees together so that they may enter into business with one another, the activities of this component will help establish a combination of a virtual platform and a physical hub, and facilitate interaction and business transaction. Moreover, the platform will be able to validate the existing research in terms of identified opportunities, distill them from other studies and update them in accordance with the current needs in the market where gaps may exist in the provision of much-needed services such as health and education (whereby micro-franchising would make sense given that lack of access with high costs to those services). Concretely, the activities contemplated include:

- (i) Development of online portal through procuring a graphic designer and a maintenance specialist, whose main functions will include:
  - a) Information repository: This repository is an easily searchable database that would offer information on micro-franchising, and the database would capture and host qualified entrepreneurs interested in micro-franchisees. The repository will include information on market analysis, franchising processes and procedures, and basic advices on legal, accounting, financing and tax, as well as success and risk factors, training and capacity-building options.
  - b) Online tools for micro-franchises: The tools would include: (1) Diagnostic tests to assess capabilities and evaluate their business health through a checklist including management practices, sales, and financing options suitable for the business. The results would be compared to the metrics of other micro-franchises, proposing potential action steps to improve sustainability; and (2) Monitoring and evaluation tool to offer a checklist of key indicators so that they can assess their progress as well as compare

themselves to similar businesses in the database. Keeping track of the scores of all the test takers would make it easy to measure progress.

- (ii) Business roundtables. This activity will organize specific business meet-ups of people who have advanced in the business development, particularly for both parties that have undergone the process described above (Component 2) and are looking to close the deal.
  - (iii) Close follow-ups of micro-franchises (both franchisors and micro-franchisees) entering into process by addressing the needs identified through the protocols (Component 3), as well as facilitating smooth execution and further reinforcing the business relations between franchisors and micro-franchisees. These business advisory will be coordinated and carried out by four Regional Facilitators (See Paragraph 2.16) placed in respective target city/region.
  - (iv) Facilitation of financing for micro-franchising. This activity will help fill the financing gap by consolidating all the possible channels of financing for both franchisors and micro-franchisees, considering suitability for each. It would include: (a) campaigns to reach potential financial partners – banks, micro-finance institutions (MFIs) and cooperatives; and (b) development of new financial products to be created jointly with financial partners such as guarantees or micro-leasing.<sup>12</sup>
- 2.10. The expected results are: (i) on-line portal developed with an information repository and diagnostics instruments, monitoring tools with the users' profiles determined (the portal will validate the potential of sectors - foods, beauty and health, textile and accessories, and entertainment and services tentatively identified as promising ones); (ii) four business roundtables organized as meeting places between the certified franchisors and certified micro-franchisees by the requirements defined in the protocols; and (iii) three inter-organizational agreements formalized to finance a total of US\$1.0 million for the micro-franchisees.

**Component IV: Knowledge Management and Strategic Communication.  
(MIF:US\$100,000; Counterpart: US\$25,000).**

- 2.11. The project will contribute to reducing the knowledge gap of Linking Small Firms with Value Chains Agenda. The objective of this component is to systematize, document, and disseminate the experience and knowledge generated in this project, with the objective to raise awareness of how effectively micro-franchise being crafted as a development tool for the vulnerable and low-income populations. As discussed above (See Paragraph 1.7), the knowledge gap to be addressed by this project is whether the

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<sup>12</sup> It is also to be noted that there are emerging crowd- funding platforms in Colombia such as Fundación Capital, with which PROPAIS has been in contact; this would address the financing needs particularly for micro-franchisees.



business format franchise is effective for achieving small businesses' growth at the targeted low-income markets.

- 2.12. The following audiences have been identified for the purpose of dissemination and communication of knowledge and experiences generated by the project: (i) Colombian government agencies, international donors and development practitioners with initiatives targeted at supporting the low-income populations through entrepreneurship and social innovation; (ii) researchers who study micro-franchise in Latin America and the Caribbean (LAC) and globally; (iii) NGOs and other project implementers; (iv) policymakers with an interest in creating better enabling environments including regulations and legal frameworks for micro-franchisees, private firms (potential franchisors) and public sector organizations. The main channels to reach these audiences will be the on-line portal to be created under Component 3, the knowledge products listed in 2.13, and workshops, meeting, seminars, social media, and events contemplated in the project.
- 2.13. The knowledge products that this project will produce include: (i) a study of best practices, benchmarking, and comparative analysis identified from the experiences in Colombia and/or in the Region, with emphasis on business format micro-franchise; and (ii) a "How to Guide" on micro-franchise to create: (a) a business format micro-franchising for Micro, Small and Medium-sized Enterprises (MSMEs) interested in expanding their businesses; and (b) multiple implementing modalities - corners, islands, mobile units, etc.- of business format micro-franchises for specific sectors in an existing business. These products will serve to analyze future and current trends in business including benchmarking on efficiency, innovation and scaling, and local context of commercialization.<sup>13</sup> As mentioned, creation of a body of knowledge on micro-franchising will set the foundation for a viable definition for the concept – which will clarify the concept and help to attract financiers and business partners alike. It is thus expected that there will be recommendations to the public policy makers on the agreed concept of micro-franchising and how to develop an integrated and comprehensive home grown micro-franchising methodology. In addition, a total of 40 institutions are expected to access the project's knowledge products.<sup>14</sup>
- 2.14. Every 12 months during project execution, the Executing Agency will update the Project Fact Sheet (template provided by the MIF), which contains basic information on the project, its challenges, the intervention strategy and results.

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<sup>13</sup> As mentioned in the paragraph 2.2, these are intended to complement the activities of the Regional Facility for Promoting the Economic Empowerment of Low Income Populations through Microenterprise Distribution Networks"(RG-M1234) where a "Regional Resource Center" –a knowledge platform on micro-franchising is expected to be established.

<sup>14</sup> As the Resource Center will be initially managed by MIF HQs, it would be easy to coordinate with the project's executing agency for crafting concrete steps to connect the project's results with the Resource Center through workshops contemplated under RG-M1234.

#### **D. Project Governance and Execution Mechanism**

- 2.15. The project's highest governing body will be the **Board of Directors** of PROP AIS to inform decisions regarding how PROP AIS will implement the project as part of their extensive ranges of work programs in many areas of micro and small enterprise development. The project execution will be directly supervised by the executive director of PROP AIS, who will report directly to the Board. The MIF project matters related to its strategic direction and reporting will be deliberated at the periodic meetings of the PROP AIS's Advisory Committee, whose members are the same as the Board members (See below Paragraph 2.17).
- 2.16. **Executing Unit.** To facilitate the project implementation, a Project Executing Unit (PEU) will be established within PROP AIS, and will be composed of Project Director, Administrative Assistant, and four Regional Facilitators. The project director, supported by the administrative assistant, will be responsible for management as well as technical and financial supervision of all the components of the project, while reporting to the Executive Director of PROP AIS. Four regional facilitators, assigned to respective region and hired for the project reporting directly to the Project Director, will perform important duties such as: (i) promoting and disseminating the project activities for key stakeholders (institutions, entrepreneurs, business communities), identifying possible synergies to be liked with the project's key partners; (ii) organizing the workshops, training sessions, technical assistance and other activities contemplated under the project; (iii) accompanying the consulting firms in the implementation of technical assistance with micro-franchisors and micro-franchisees.
- 2.17. Furthermore, to ensure that the project has feedback and advice from the different project related areas, an **Advisory Committee** will be formed by representatives from the Board of Directors of PROP AIS who are experts in business development, value chain management, inclusive business, entrepreneurship and public policy. The Advisory Committee that will meet periodically as part of the PROP AIS's Board meeting will discuss the strategic matters of the MIF project and provide advice, as appropriate, to the PEU. The members of the Committee are from Ministry of Commerce, Industry and Tourism (MCIT), Department of National Planning (DNP), National Service for Learning (SENA), Department of Social Prosperity (DPS), National Association of Franchise, Colombian Association of Small and Medium-sized Industries (ACOPI), and Fundacion Coomeva.

#### **E. Sustainability**

- 2.18. Sustainability is crucial to protect micro-franchising against being considered a subsistence tool. This is why the project seeks to support the systematization of information, methodologies, and best practices, as well as the creation of a community, in which not only franchisors and micro-franchisees, but also other business actors, government, NGOs, universities, financial institutions, investors, consultants, and other

supporting institutions are encouraged to interact. The project's theory of change is that the proposed marketplace platform would be most effective in order to attract resources and draw attention to the common goal (importantly, common definition); once the platform's value recognized, it would be able to charge user fees for the services it provides, which would, in turn, increase the project's long-term sustainability.

## **F. Experience and Lessons Learned from MIF or other Institutions**

- 2.19. There are several relevant lessons learned from similar projects executed in the past<sup>15</sup>:
- (i) There is a persistent misperception about franchise and its economic function, as many stakeholders associate the concept of franchise only with large corporations, foreign brands, and large-scale investors; thus it is important to reach out not only the interested parties in franchise but also a broader range of stakeholders including small business associations, academia, mass media as well as public policy making institutions.
  - (ii) It is important to direct equal attention to franchisors as well as franchisees. Often franchisors with high potential for growth may require equally qualified capabilities to develop businesses among potential franchisees.
  - (iii) It is necessary to strengthen the general SMEs community on the subjects of knowledge about commercial values of intellectual property rights as well as the corporate image and know-how.
  - (iv) Not every SME is franchisable; given the heterogeneity in business development that characterizes Colombian SMEs, it is essential to define and adapt realistic criteria for selection of participating SMEs (both franchisors and franchisees), examining the potential for franchising prior to the intervention of consultancy.
  - (v) Defining not only selection criteria but also exit criteria is important. Those criteria should be flexible enough to detect early cases where either party (franchisor or micro-franchisee) is not prepared to engage in franchise business.
  - (vi) The executing agencies not only need to be knowledgeable about the concept of franchise, but also need to have experiences in working with organizational development of SMEs in general.

## **G. MIF Additionality**

- 2.20. Non-Financial Additionality. Colombia is at a critical juncture with regards to micro-franchising. If some of the actors continue to define the concept ambiguously, or implement programs poorly, this might lead to tarnishing the concept, which could have significant adverse effects on attracting partnerships and funding in the future. With its convening power, MIF can leverage its experiences, networks, and resources to promote and organize actors who have divergent views, and support the growth of this relatively unknown industry. Through this project, the MIF will prove that micro-

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<sup>15</sup> They include the lessons from the MIF project "Growing Micro, Small and Medium-sized Enterprises in Colombia through Franchising (CO-M1016).

franchising is an important development tool if used appropriately, addressing the current vacuum of leadership in Colombia.

- 2.21. Financial Additionality. While there are funds to implement the existing proven model, few funding sources are willing to finance the development of new models.

#### **H. Project Results**

- 2.22. The result level indicators will be: (i) 20 micro-franchisors (most likely growing small/medium-sized firms) implementing “business format” micro-franchising models; (ii) 200 micro-franchisees who start a new business; (iii) 100 micro-franchisees will be women-owned; and (iv) 100 micro-franchisees access a credit financial product to start franchise businesses.
- 2.23. Adoption and Scaling. Close coordination will be pursued with the Bank’s private sector arms such as SCF and OMJ to identify potential scaling options, particularly when the poor and low-income communities would benefit as a result of the new products and services offered at higher quality and lower prices.

#### **I. Project Impact**

- 2.24. The impact indicators will be: (i) 20% average annual sales growth of micro-franchises created; (ii) 400 jobs generated as employees of the new micro-franchises; (iv) 100 micro-franchises that continue in operation 3 years after program interventions; and (iv) 5% increase in the sales (on average) for 20 franchisors; and (v) Average wage of the employees at the micro-franchisees reaching at least a legally valid monthly minimum wage.

#### **J. Systemic Impact**

- 2.25. The systemic impact will be: (i) the number (at least 10) key public and private actors/institutions changing or applying new concepts and practices based on the project; and (ii) the number (at least 2) of new policies, regulations and/or legal framework of micro-franchising. As mentioned above, the project results would be scaled through the Bank’s private sector arms such as SCF and OMJ.

### **3. MONITORING AND EVALUATION STRATEGY**

- 3.1. Baseline: Baseline data will be gathered at the beginning of the project. The baseline includes specific numbers (sales, profits, and employment), and in all cases the data will be disaggregated by gender, level of education, age, type of business/sector and other information relevant to the results of the project over time. The project also will work with the Colombian Government’s Agency for Overcoming Extreme Poverty (ANSPE), which has information on the living standards and characteristics of those families.

- 3.2. Monitoring Mechanisms: Result indicators will be measured during the life of the project with the information system, created under similar projects of micro-enterprise development executed by PROPAIS; the metrics currently used will be evaluated and improved, and new variables can be included if necessary. The on-line portal to be developed under Component 3 will refine the existing monitoring system.
- 3.3. Evaluation: The key evaluation questions are: (i) What were the key factors that (a) enabled (or discouraged) business format micro-franchises to sustainably perform as a growing business and (b) allowed a rapid scaling of new businesses at the target low-income populations markets? (ii) What exactly “social” benefits, as claimed by development advocates, were created for the vulnerable and low-income populations and underserved communities through micro-franchise models? (iii) How did micro-franchisors overcome a series of challenges derived from institutional contexts that would characterize the target markets such as principal-agent problem and resource scarcity? (iv) Was evidence generated to suggest that the overall business format micro-franchising model sustainable?
- 3.4. Impact Evaluation: Because of the limited sample size and foreseen difficulty in constructing counterfactuals due to heterogeneity of firm-level targets (several different sectors expected), the project does not contemplate conducting an impact evaluation; however, an ex post evaluation on this project will be conducted as it expects to learn about the effects of different business models within the category of business format franchising, thus filling the knowledge gap explained earlier.

#### 4. COST AND FINANCING

- 4.1. The project has a total cost of US\$ 2,540,150, of which US\$1,332,000 will be provided by the MIF on a non-reimbursable basis, and US\$1,208,150 by the counterpart. The execution period will be of 42 months and the disbursement period will be of 48 months.

Components	MIF	Counterpart	Total
Component 1. <b>Awareness and Fomenting Actions</b>	95,000	144,950	239,950
Component 2. <b>Capacity Building for Micro-franchises</b>	182,000	408,200	590,200
Component 3. <b>Development of Micro-franchise Marketplace</b>	410,000	227,000	637,000
Component 4. <b>Knowledge Management and Strategic Communications</b>	100,000	25,000	125,000
Management/Executing Agency Administration	336,000	403,000	739,000
Baseline, Monitoring and Evaluation	60,000		60,000
Ex post reviews	30,000		30,000
Contingencies	32,400		32,400
<b>Sub-total</b>	<b>1,245,400</b>	<b>1,208,150</b>	<b>2,453,550</b>
<b>% of Financing</b>	<b>51%</b>	<b>49%</b>	<b>100%</b>

Impact Evaluation Account (5%)	66,600		66,600
Agenda Account	20,000		20,000
<b>Grand Total</b>	<b>1,332,000</b>	<b>1,208,150</b>	<b>2,540,150</b>

## 5. EXECUTING AGENCY

### A. Executing Agency

- 5.1. The project will be executed by la Corporación para el Desarrollo de las Microempresas (PROPAIS). PROPAIS, created in 1994, is a not-for profit organization with a hybrid character- owned by the government, but managed as a private entity. Partnering with 80 private entities and 10 public organizations, PROPAIS is an umbrella type organization with a mandate to support micro and small firms. It employs 10 permanent staff, while more than 30 professionals work for other projects. The annual operating budget is approximately US\$800,000.
- 5.2. Institution's Core Business. The mission of PROPAIS is to develop and promote public policy related to microenterprise development through strategic alliances with public and private partnerships, including information capturing, designing, and implementing pilot projects. PROPAIS through its principal governmental shareholder, the Ministry of Commerce, Industry and Trade (MCIT), is capable of convening a group of key stakeholders, helping spur and organize the discussion at a national level. PROPAIS has implemented numerous programs focusing on entrepreneurship at the Base of the Pyramid, covering major cities across the country.
- 5.3. Other Partners. The project could use information and resources from other key partners involved: SENA; Coomeva; National and Regional Entrepreneurship Networks; Chambers of Commerce; Bancoldex; MFI and cooperatives; MCIT; and existing social entrepreneurship programs, accelerators/incubators such as Ashoka and Compartamos. The National Association of Franchise that has been recently established is likely to be an important partner. Given that the Association has not yet undertaken specific programs, the Executing Agency will explore effective ways of collaboration with the Association during the project execution.

## 6. PROJECT RISKS

- 6.1. A lack of coherent legal framework would prevent the emergence of a nascent industry of micro-franchising, making it difficult for the franchisor to exert a degree of control, while blurring the requirements of the franchisee to follow the franchisor's method. It would be worrisome that the franchisors, although they could take measures based on the particular contract they signed with the micro-franchisee, would be unable to enforce it even if micro-franchisees did not comply with the franchising agreement. Besides, disclosure needs to be ensured (fees, required investment, time commitment, financial statement and litigation), while lack of the same would fail to protect the

buyers of the franchise who in this case are low-income people. If these safeguards are weak, an economic empowerment opportunity may become the reason for the micro-entrepreneurs to fall below the poverty line. The proposed marketplace would enforce disclosure, protecting potential franchisors and micro-franchisees alike.<sup>16</sup> The results of the project are also expected to potentially set the stage for a new micro-franchising law.

## **7. ENVIRONMENTAL AND SOCIAL EFFECTS**

- 7.1. This operation was screened on March 6, 2014 and classified as required by the IDB's safeguard policy (OP-703). Given the limited impacts and risks, the proposed category for the project is C.

## **8. COMPLIANCE WITH MILESTONES AND SPECIAL FIDUCIARY ARRANGEMENTS**

- 8.1. **Disbursement by Results and Fiduciary Arrangements.** The Executing Agency will adhere to the standard MIF disbursement by results, procurement and financial management arrangements specified in the project technical file.

## **9. INFORMATION DISCLOSURE**

- 9.1 **Information Disclosure.** Under the Access to Information Policy of the Bank, this document is subject to public disclosure.

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<sup>16</sup> Other than the US law, the franchising legislation from Brazil and Mexico can be a good benchmark. It requires a document by which franchisee can make an informed decision considering financials, intellectual property, contract expiration, as well as right to support offered to the franchisees, and obligation to buy certain materials from the franchisor.