

## An investigation of the franchising option for water services in South Africa

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*There is a need in South Africa for institutional innovations aimed at increasing the coverage of water services, and sustaining those services. The paper describes an investigation of an alternative service delivery institutional model, viz the franchising of water services. The paper describes the need for a franchise model that could be developed and made available to emerging entrepreneurs as the basis of a viable business. The franchise would be in respect of components of the water services value chain that are suitable for small business in that they can be readily systematised.*

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### Introduction

The capacity of many municipalities in South Africa to adequately provide even basic levels of water services to all their citizens is in question. The need for new alternative service provider institutions is apparent.

Both the parastatal regional bulk water supplier Rand Water and the national Department of Water Affairs and Forestry (DWAF) have for a number of years considered that the potential for franchising in the water services industry water ought to be investigated. For various reasons this has never been done.

### The CSIR Report

The paper describes the first phase of an investigation, undertaken during the 2003/2004 financial year by the Council for Scientific and Industrial Research (CSIR), into franchising in the water services sector in South Africa. This phase comprised:

- background investigation of water services delivery in South Africa;
- background investigation of franchising generically (i.e. not in the water services sector) and of South African experience and best practice;
- background investigation of research into and experience in franchising in the water services sector worldwide; and
- investigation of and assessment of appropriateness of franchising to the water services sector in South Africa.

### Franchising

The barriers to entry for the smaller or start-up company in any field of enterprise are substantial. But if these could be overcome, perhaps through franchising, then there will be many opportunities for local economic development. The twin driving forces of the franchising concept are:

- an incentive in the form of a focused and quantifiable financial outcome (profits, dividends or surplus); and
- a successful business model that can be copied widely.

Franchising (more correctly “business format franchising”) is a way of accelerating the development of a business, based on tried and tested methodology. The franchise system firstly correlates and systematises the business, and then facilitates the setting up of the business, and supports and disciplines it thereafter.

The cardinal elements of the franchise process are:

- identifying a component (or components) of the value chain that is simple enough to systematise;
- discovering best practice;
- systematising the business;
- selecting franchisors and franchisees;
- training;
- preparation of operations manuals;
- research and development; and
- continuing support, control and discipline of the on-going business.

For-profit franchising of commercial goods and services in South Africa is extensive, generally viable, and growing rapidly. Over 400 franchised systems operate through more than 26 000 franchised outlets, and generate retail sales around R200 billion (US\$35 billion) annually. Significant numbers of jobs have been created. There is much evidence that, everything else being equal, franchised businesses have a far lower failure rate than do independent businesses.

### The Findings

Municipalities in South Africa already have a huge responsibility for water services operation and maintenance – The Development Bank of Southern Africa, DWAF and the national Department of Provincial and Local Government

alone between 1994 and 2003 funded of the order of at least R15 billion (approximately US\$2300 million at current exchange rates) investment in water services new works, upgrading and rehabilitation. All of this, and also the infrastructure funded by other means, has become the responsibility of municipalities to operate and maintain. In addition, a significant proportion of the South African population does not enjoy safe water and/or acceptable sanitation – this represents a huge responsibility for the construction of new infrastructure and, after its construction, its operation and maintenance by municipalities.

Even if all the existing institutional roleplayers were coping with the water services delivery responsibility, there would be good reason to investigate alternative institutional models, on the grounds that it needs to be found out if alternatives:

- could be more cost-effective;
- could allow existing roleplayers to focus on their other responsibilities; or
- could offer a range of other advantages (including greater community participation).

Even in the well-resourced cities, water losses, for example, are significant, due largely to a legacy of underfunded maintenance budgets and inadequate maintenance practices. Generally, the situation is worse in the less well-resourced areas.

Thus, given that the existing institutional roleplayers are clearly not coping with all the needs, there is definitely a “**push factor**” reason to investigate alternative institutional models for water services delivery.

Internationally, it has been recognised that there is a need for partnerships between public, private and civil institutions to achieve water services delivery objectives. The variety of partnerships that has been implemented, viz. private sector concessions, Build-Operate-Transfer (BOT), Build-Operate-Train-Transfer (BOTT), etc., has enjoyed mixed success overseas and in South Africa. These have generally been “big business” partnerships for large scale contracts, and generally investment (public or private) in new infrastructure plays a prominent role.

There is an alternative service delivery institutional model that is suited more for the ongoing operation and maintenance of water services systems, rather than for investment in new infrastructure – and that is friendly to small business. This alternative is the franchising of water services. However there is little experience of this approach anywhere in the world, and no experience in South Africa – although some partnerships have some of the characteristics of the franchise approach.

Neither of the “twin driving forces” of the franchise concept, referred to above, is currently in evidence in the water services sector in South Africa. Furthermore, there are many pitfalls when it comes to implementation even under the most favourable of circumstances.

A survey of overseas literature, while conceding that the topic of water services franchising is a very new one, and

implementation even at a pilot scale is yet to take place, concluded that water services franchising shows great promise. Especially this is so in respect of water services to towns and to multi-village schemes. However franchising would be by no means free of many of the issues that equally affect other water services provision alternatives – franchising would be just as dependent on the criteria for sustainable operations being in place, in particular the criterion of financial self-sustainability.

The need in South Africa for less unemployment, for higher household incomes, and for more entrepreneurs, is unquestionable. It is intolerable that of the order of 40% of those between 15 and 65 are unemployed. Furthermore, South Africa ranked lowly in a recent global entrepreneurship survey, indicating failure to create a competitive climate in which emerging businesses can grow and thrive. Thus there is without question a “**pull factor**”, i.e. the need for local economic development, and in particular the need for the creation and nurturing of small, medium and micro-enterprises (SMMEs), that strongly motivates the investigation of franchising in South Africa as a water services delivery model in addition to, and probably complementary to, the current models.

Resources allocated to a programme for the franchising of water services would be well spent in terms of achieving sustainable jobs and entrepreneurs – not to mention the water services delivery that would ensue. Many useful pointers for the water services franchisee development programme that will be needed, if franchising of water services is to take off, can be found not only in business format franchising franchisee development programmes, but also in engineering infrastructure contractor development programmes that already have a track record in South Africa (for example the Soweto Contractor Development Programme).

The CSIR report found that the great need for alternative water services provider systems, and for local economic development, is indisputable, and that there is through water services franchising potential to simultaneously:

- deliver water services; and
- promote local economic development, SMME development and (a major national government objective) Black economic empowerment.

Thus “franchisee” must be added to the list of possible water services provider types in South African water services practice.

The CSIR report also found that it is essential to the success of water services franchising that, inter alia:

- service to customers meets the specification in the franchise contract with the water services authority;
- suitable franchisors are willing and available;
- local entrepreneurs are willing to take up water services franchise opportunities;
- franchising proves to be a viable business for franchisor and franchisee alike; and

- the funding partners support water services franchising in just the same way as they support in comparable circumstances water services provision by other institutional means.

On the last of these points: Franchising must benefit from the funding streams (e.g. the “Equitable share” programme, a national government major welfare funding programme directed at the poorer municipalities) to the water services authority to the same extent as these streams benefit any other type of water services provider. National government must perceive that going the franchise route has in a significant number of circumstances at least as good or maybe an even a better chance of providing sustainable water services than any other option has.

It is not unreasonable that entrepreneurs can be contracted to supply water services, and take the profits that their contracts permit. There should be no ideological barrier to this – and given that there are currently not enough water services providers in South Africa, entrepreneurs should be offered the opportunity to see if they can assist. However the case for franchising does not depend on the case for or against the participation of for-profit organisations. There are current activities in the water services sector in South Africa that have some elements in common with franchising. But they also have differences, the most important of which is that the participants are generally not for-profits (in particular, that in which a water services authority appoints a “support services agent” to support smaller locally-based water services providers).

Two organisations, one a parastatal and one from the private sector, that have the expertise and resources to play a franchisor role, have expressed interest. There is little doubt that other capable organisations would be interested were they to see the potential.

A South African water services franchising programme must commence by learning from the performance of other water services institutional arrangements. Experience must also be derived from franchising experience in business sectors other than water services. Only thereafter can the implementation of such a programme be contemplated, and even then at pilot scale as field experiments, and subject to structured research methodology. Furthermore, the initial piloting must be done in the easiest of circumstances, where there is the greatest chance of success. If piloting is attempted in a problematic area, and if the pilot is not completely successful, not enough would have been learned from the pilot implementation to draw any worthwhile conclusions.

To sum up the CSIR’s findings:

- the potential of water services franchising in South Africa is clearly demonstrated; and
- the circumstances are now entirely right for a more in-depth investigation into water services franchising, to be followed by implementation at pilot scale.

## The Way Forward

The current financial year (2004/2005) has seen the CSIR in the initial stages of formulating a number of proposals that it is hoped will in due course become pilot projects. These proposals can readily be grouped into two types, as follows:

- proposals that would lead to the establishment of franchisee water services providers, offering a full range of water services; and
- proposals that would lead to the establishment of franchisees who would offer selected services under contract to water services providers.

In respect of the first, initial discussions have been with DWAF, with a view to structuring a partnership between themselves (providing technical and funding support) and a water services authority (a municipality) that is responsible for areas including small towns and rural villages. The intention is to set up a pilot project in a selected area, that would involve the development of a local franchisee as the full-service water services provider for the area. The franchisor would be one of the well-resourced organisations that has already expressed interest in playing this role.

Another “full-service” type of project is being put together that will, if it is approved, be led by a regional bulk water supplier that also has responsibilities for water services to small towns and rural areas. If this goes ahead, the end result in a few years’ time should be a couple of pilot schemes in operation, and a strategy for rolling water services franchising out across a portion of KwaZulu-Natal province. Before then, however, a lot of work will have to have been done on systematising water services provision, preparation of operations manuals, design of systems to support the on-going business, and the preparation and approval of business plans.

The second type of proposal that is being worked on is somewhat different, and may best be explained by way of describing what at the time of writing is the most comprehensively formulated of the several promising prospects being worked upon. About two dozen years ago, a young Pretoria plumber who had started out on his own realised that the only way to replicate the prompt service that had become his business’ trademark was to franchise the business. Which he duly did, and the business has grown rapidly ever since. He subsequently added an electrical business, and in due course franchised that also.

However all of his custom has been from the owners of commercial properties and the higher-income residential properties. The current proposal is to extend, to the vast residential townships where the municipality is the property owner, the kind of service that he provides elsewhere. Affordability in these townships is, generally speaking, low, and when a plumbing problem occurs the residents either wait for the municipality to fix it (which could take days, and meantime water is wasted or wastewater backs up, depending on the nature of the problem), or they fix it themselves or

get a neighbourhood amateur to fix it for them, invariably inadequately. The proposal is to structure a deal with the municipality, whereby the plumber-businessman referred to above selects local residents, sets them up as franchisees, trains them in the technical and business skills, and in all ways acts as franchisor as he does elsewhere in Pretoria. The municipality would have to subvent the business to make it viable. However preliminary estimates suggests that this will cost the municipality less than it is presently spending in the townships, and it will in return have the assurance that the residents will receive a much higher service than they presently do.

Although it is at the time of writing still early days in respect of these proposals, the prospects for water services franchising in South Africa do appear promising.

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