

# Using a franchise structure to scale affordable housing internationally

*Julie Anne McBride and Eric Oetjen*

**Abstract:** *Capital investment as high as US\$16 tn is required to address the shortage of adequate and affordable housing worldwide. Market-driven housing approaches that produce quality units, reduce dwelling costs, and provide access to a range of capital sources can help to solve this challenge. This article describes the experience of a social enterprise in Mexico that is taking its proven, market-driven housing solution to countries in Africa using a joint venture franchising company to execute a master franchising strategy. Its experience and the innovative approach it used to scale internationally offer useful insights and lessons for housing practitioners, policymakers, and researchers.*

**Keywords:** social enterprise, social entrepreneurship, affordable housing, international franchising, social impact, social franchising

## Introduction

In 2016, the World Bank estimated that 1.2 billion people lived in substandard housing (World Bank, 2016). Looking forward, this same report projected that 3 billion people would need new housing and basic infrastructure by 2030 based on expected population and social trends. Improving access to adequate housing is a priority for many governments and global organizations because, as the McKinsey Global Institute reported in its analysis of the global affordable housing challenge: ‘For families lacking decent affordable housing, health outcomes are poorer, children do less well in school and tend to drop out earlier, unemployment and underemployment rates are higher, and financial inclusion is lower’ (Woetzel et al., 2014: 3). The study estimated that the investment required to close the affordable housing gap could be as high as US\$16 tn. Private capital could provide a substantial share of the investment required to address this gap, with an estimated \$1–3 bn needed from public sources.

In Mexico, the National Housing Commission estimates that 9.4 million people do not have housing and an additional 4.9 million live in overcrowded conditions or in poorly constructed homes. UN-Habitat found a similar gap and expressed concern that: ‘The current housing finance policy focuses on the population with formal employment and enough income to obtain a mortgage loan.’ It also found that: ‘more than 50% of the housing units built in the last two decades are located in only 8 of the 32 states’ (UN-Habitat, 2018: 8). The housing need in the south and south-west states is unmet.

One of the key hurdles facing the housing sector is finding viable, market-driven housing solutions that efficiently provide suitable housing and rely primarily on

private capital. This article describes how ECHALE, a Mexican social enterprise, has chosen franchising to expand its affordable housing solution internationally, the benefits of the model, and its experience to date.

### **Application of franchising to social enterprise**

Franchising is a structure for distributing goods and services. In the United States, the term ‘franchising’ is defined under the Federal Trade Commission Franchise Rule, and has three elements: first, the franchisor grants the franchisee the right to operate a business that is identified by or associated with the franchisor’s marks; second, the franchisor must provide significant assistance or exert significant control over the franchisee’s method of operation; and third, in exchange for the first two elements, the franchisee makes a required payment to the franchisor (16 C.F.R. Section 436.1(h)). This definition is similar to that of most other countries that have adopted franchise laws.

The Federal Trade Commission Rule definition also applies to master franchising. In the case of a master franchise, the master franchisee’s use of the marks is typically in connection with offering sub-franchises to unit-level sub-franchisees who, in turn, offer goods or services under the brand directly to the end-user consumers. In effect, a master franchisee becomes a ‘mini-franchisor’ for the purpose of offering services to its unit level sub-franchisees.

Franchising benefits franchisors by providing an efficient way to grow their businesses, while offering franchisees the opportunity to become successful business owners. Based on findings from several studies, Rosado-Serrano, Paul, and Dikova commented in the *Journal of Business Research*: ‘No one doubts that certain benefits accrue to both franchisors and franchisees such as access to a proven business concept and system for the franchisee and access to local market opportunities and knowledge for the franchisor’ (Rosado-Serrano et al., 2018: 253).

Communities also benefit from franchising. In his article ‘Can franchising be an economic development strategy? An empirical investigation’, Steven Michael found that franchising contributes to economic development by creating business ownership opportunities and jobs. The article further suggests that international franchising produces a spillover effect in host countries through the transfer of valuable management and marketing skills to the workforce (Michael, 2014). Similarly, Ilan Alon (2006) writes in *Multinational Business Review* that franchising’s economic impact on host countries includes increased output and job creation, an increase in the tax base, economic modernization, small and medium enterprise (SME) and entrepreneurship development, and the acquisition of dynamic capabilities and skills. Franchising, then, benefits a range of stakeholders and has spillover effects in the communities in which they operate.

### ***Franchising applied to social enterprises expanding internationally***

According to the Social Enterprise Alliance, social enterprises are ‘Organizations that address a basic unmet need or solve a social or environmental problem through

a market-driven approach' (Social Enterprise Alliance, n.d.). The use of franchising to expand the distribution of social enterprises is emerging as a promising model for scaling impact (Starbird et al., 2021). When deciding whether to expand to international markets, organizations face a range of considerations. These include micro-level factors such as management capabilities, market knowledge, financial capacity, motivation to expand overseas and international experience; and macro-environmental factors such as cultural distance, political context, geographic distance, economic development, and legal context (Rosado-Serrano et al., 2018). Franchising, and master franchising in particular, provide a structure for addressing micro- and macro-level barriers to expansion. Firms tend to choose master franchising for international expansion when there is a substantial need for local adaptation. It also helps avoid the high cost of supporting and monitoring franchisees directly (Rosado-Serrano et al., 2018).

Local social enterprise owners can be reluctant to pursue international franchising due to their limited overseas experience. Ilan Alon (2006) and others found a direct correlation between international experience and a firm's propensity to engage in international franchising. Further, hesitation around implementation of an international franchise strategy can put the business at risk. Rosado-Serrano et al. (2018: 242) highlighted several studies with findings supporting the view that 'international franchising fails without the commitment of managers, the commitment of employees in almost every department, dedicated resources, and patience'. Their literature review identified findings from several studies showing an inverse relationship between geographic and cultural distance and the organization's desire for expansion to the country. For these reasons, organizations are wise to consider establishing partnerships to manage franchise operations abroad.

### **ECHALE's housing solution in Mexico**

ECHALE was established in 1997 with a mission of providing affordable quality houses for sale to lower- and middle-income families and fostering strong communities. It primarily targets the traditionally underserved market of households with incomes at 150 per cent of poverty level or below. It successfully produces durable, eco-friendly houses with safe drinking water, sanitation, electricity, and street access. These homes cost substantially less than a new or existing conventional house of standard quality in the area. They meet the buyer's shelter needs, while also providing a foundation for improving health and economic circumstances.

The households that ECHALE serves typically spend at least 30 per cent of their income on materials to episodically construct their own houses over a period of 10–15 years, without a sound design or technical assistance. The result is often a poor-quality house with little or no equity value and unpredictable and burdensome maintenance needs. This housing reality fuels a vicious cycle of poverty that plagues many communities in Mexico, as well as in other countries. When households can purchase quality, affordable homes, they can break this cycle.

**Box 1 Suselina's story**

Suselina, aged 24, is a single mother living in Tabasco, located in south-eastern Mexico. She has a daughter, aged 4, and supports her two younger sisters. Previously, they paid rent to live in a 280-square-foot (26 m<sup>2</sup>) cardboard sheet house with a dirt floor and no running water, and no electricity or drainage. Now, they are buying a house built by ECHALE that has two bedrooms, a bathroom, a kitchen, a dining room, safe drinking water, electricity, sanitation, and a backyard. Today, their mortgage payment is \$60 per month, the same amount as the rent they previously paid.

**Addressing key barriers to homeownership**

ECHALE's approach addresses four critical, interrelated barriers to home ownership: 1) securing access to suitable land; 2) finding adequate, affordable houses; 3) meeting ownership and debt responsibilities; and 4) qualifying for mortgage finance.

*Inexpensive, suitable land for homeownership.* In Mexico, as in many countries, households that would like to build a house frequently face difficulties finding land to buy where transferable ownership can be readily established to protect their investment. Additionally, such land can be expensive or lack fundamental infrastructure for power, water, sanitation, and drainage. ECHALE obtains plots of land suitable for 40 to 120 homes, reducing land-related costs through economies of scale. It adds essential site infrastructure (electricity, safe drinking water, sanitation, and road access), and works with the Mexican government's National Institute for Sustainable Land (INSUS) to subdivide the land and provide titles. In some locations, donations or price reductions have been negotiated to further lower land-related costs, opening access to households at lower income levels.

*Quality, adaptable, and durable home designs affordable for lower- and middle-income households.* ECHALE estimates that its homes cost 30 to 50 per cent less than a new or existing conventional home with comparable features. Durable adobe blocks serve as the primary construction material for its homes. Less expensive than concrete, these blocks are produced at the building site largely from local materials with minimal environmental impact, using patented 'eco-block' technology developed over 20 years. Other building components are locally available and can be purchased in bulk. A range of standard house designs in different sizes have proven to be durable and inexpensive to maintain. Construction of houses in groups provides economies of scale. Much of the labour can be supplied by household members and local people overseen by experienced supervisors. All labour is paid and allocated to the cost of the home, but this cost is substantially less than a conventionally built home.

*Finance and homeownership education.* Working with over 50,000 households, ECHALE found that buyers lacked the preparation necessary to obtain financing and fulfil the responsibilities of homeownership. The company was already teaching households construction skills to reduce labour costs, and has added finance and homeowner education to those workshops. Sessions include: financial budgeting skills; saving discipline; making timely loan payments; homeowner

responsibilities (e.g. utility payments, legal duties); and home maintenance. This education benefits the homeowner, while also benefiting investors through lower default risk.

*Timely, reliable access to suitable mortgage financing.* Often, potential homebuyers earn sufficient income to repay a housing loan but lack documented earning and credit history acceptable to formal lenders. The only remaining option for many buyers is the informal credit market with high interest rates, onerous loan terms, and uncertain processing times. To address this challenge ECHALE formed a wholly owned company, ECHALE Mejoramiento, in 2014 as a Community Financial Society registered with the Mexican National Banking Commission. Families working with ECHALE must save and contribute a minimum of 10 per cent of the total cost of the home they purchase. ECHALE Mejoramiento offers participating families savings products to help with down payments and future housing expenses, and mortgage loans to help finance construction. Currently, two savings products are available: a regular savings account with a modest interest rate (around 2 per cent) and a fixed term savings account that offers a slightly higher rate (around 3 to 3.5 per cent) for a term of 5 years. Its mortgage loans finance up to 90 per cent of the value of the home with terms of four to six years. The average lending rate between 2018 and 2020 was 30 per cent, substantially lower than the informal credit market.

ECHALE is successful in a range of markets in Mexico for two reasons: 1) The housing product meets a recognized demand across markets; and 2) attractive financing terms, combined with buyer education, support a strong mortgage repayment rate (the default rate on ECHALE Mejoramiento's housing loans is less than 2 per cent). The performance of ECHALE Mejoramiento's mortgage loan portfolio has allowed it to continue to attract impact investment and other capital to support its growth in new markets, while maintaining interest rates that are affordable to lower- and middle-income homebuyers.

### **Using a joint venture and master franchise structure to leverage the potential of franchising**

ECHALE's growth and success in Mexico led its leaders to explore the feasibility of expanding internationally. In 2019, ECHALE hired Stage Six, an international social franchise advisory firm, to assess the feasibility and appropriateness of franchising to expand into new countries. They found that ECHALE met the criteria required for franchising to succeed; namely that their overall approach and specific processes had been tested, refined, and codified in a way that yields consistent results across a wide range of circumstances. Further, the size of the global market opportunity and attractiveness of their offering to both homebuyers and local developers strongly suggested a healthy market for ECHALE franchises. As described in the following section, Africa was selected as the initial geography for expansion. The consultants cautioned, however, that ECHALE's reluctance to reallocate sufficient resources from local operations to international operations

would hinder their progress. To overcome this initial resource hurdle, ECHALE determined that a joint venture company responsible for international franchise operations, and a master franchising structure to localize franchisee support, would allow the ECHALE brand to grow without risk to the Mexican operations.

### ***Establishing the franchisor***

In 2020 ECHALE and Stage Six created ECHALE International (EI). It functions as the ECHALE franchisor and has the rights to develop the franchise throughout Africa. Its ownership is shared between ECHALE (20 per cent) and Stage Six (80 per cent) and it is registered as a C-Corp in the United States. Establishing the franchisor as a separate entity allows ECHALE to avoid the entanglement of competing interests within the company, while Stage Six provides immediate access to a knowledgeable and capable franchise management team. Stage Six's extensive international experience and network of social entrepreneurs increases ECHALE's ability to capitalize on market opportunities outside Latin America.

### ***Selecting Africa***

ECHALE's expansion goals include other countries in Latin America, where a company-owned growth strategy may be preferred. For expansion outside the region, EI chose to develop the franchise programme for Africa for three reasons:

- *Strong interest in ECHALE's housing solution* from African developers, government officials, and other professionals working in the housing sector who see the potential for success in both rural and peri urban communities.
- *Similar housing market needs and challenges* to those ECHALE is addressing in a diverse range of communities across Mexico, as described above: 1) securing access to suitable land; 2) finding adequate, affordable houses; 3) meeting ownership and debt responsibilities; and 4) qualifying for mortgage finance. Differences in local housing markets, building requirements, culture, and environmental conditions exist, but do not appear to require a fundamental change in approach.
- *Geographic experience* of Stage Six helped access local real estate knowledge and expertise in Uganda, Kenya, and Malawi. Stage Six's team members have worked with social franchises across a range of sectors, including water, health care, sanitation, clean energy, and early childhood development in Africa for more than 20 years. As a result, they are able to navigate the social, cultural, economic, and political environment effectively.

### ***Enabling local adaptation and efficiency***

EI selected a master franchising model to facilitate introduction of the ECHALE franchise in African countries. Under this structure, EI licenses the right to operate the franchise unit, and/or grant franchise rights to others, to local firms known as master franchisees. Master franchisees are responsible for adapting the ECHALE franchise to the local context and expanding the franchise in their country.

EI recruits and enters into master franchise agreements with developers in Africa seeking to develop affordable single-family homes using ECHALE's approach and product. Master franchisees in each country must have the credentials to finance and operate the ECHALE model. These credentials include a successful track record, a solid reputation, good credit history, appropriate education and experience, and other relevant expertise. Master franchisees are responsible for using their market knowledge to adapt ECHALE to the local context and build positive relationships with local stakeholders to facilitate growth of the business.

The master franchise agreement establishes the fee to be paid for the franchise rights, and an ongoing royalty payment to cover EI's support costs. It also contractually obligates the master franchisee to pursue ECHALE's social impact goals simultaneously with the business goals of both EI and the master franchisee. Master franchisees commit to target lower and middle-income households as buyers, use approved ECHALE home designs, and implement agreed upon construction and operating practices.

Table 1 summarizes the benefits of the master franchise model to EI and master franchisees.

**Table 1** Benefits of EI's franchise agreement

<i>Benefits to master franchisees</i>	<i>Benefits to EI</i>
New source of revenue and financial return on equity	Increased social impact due to increase in number of households served
Use of ECHALE brand, home designs, operating practices, and eco-block machines	Revenue in the form of franchise fees and royalties
Access to equity capital from EI to help finance start-up costs	Financial return on equity
Access to debt financing for start-up costs at affordable interest rates	Ability to attract private and public investment in EI due to its greater capacity to achieve social impact
Access to training and technical resources from EI	Opportunity to learn from franchisees and innovate new products
Support from EI in seeking investment from impact investors and other sources of capital	

The franchise agreement also supports accountability of both EI and the master franchisee. Incentives to meet the terms of the agreement include access to additional investment or support, while financial consequences for failing to do so include monetary penalties, loss of equity, or loss of access to capital. These provide strong motivation for both EI and its franchisees to fulfil their responsibilities.

### ***Conveying and adapting the ECHALE approach, product, and operating model***

One of EI's responsibilities as franchisor is to help build franchisee capacity during the start-up period to the point that it can produce ECHALE-type homes using established construction and operating practices. It does so in the following ways:

- *Increase construction capacity.* EI supports franchisees by providing standard house designs, construction management guides and tools, operating manuals, training sessions, and direct technical support (e.g. demonstrating the operation of the eco-block machine).
- *Adapt home designs and operating practices.* EI has adapted the standard ECHALE house designs for Malawi and Uganda so that the homes achieve the desired performance in those countries and the local preferences are addressed. ECHALE staff also work directly with master franchisee staff to revise standard operating practices where required, given local market conditions and requirements.
- *Facilitate access to mortgage financing.* EI assists master franchisees to assess whether local banks or other lenders will provide suitable mortgages, or if they can work with a recognized micro-credit lender to offer financing for buyers.

This capacity building support contributes to better performance in terms of the quality, efficiency, and volume of a master franchisee's business, and ensures its operating practices are appropriate given local markets, building requirements, and culture.

### ***Early progress in Africa***

While EI is just starting its expansion of ECHALE in Africa, initial indicators are promising. Malawi and Uganda were selected as the initial countries to launch the ECHALE franchise, influenced primarily by the quality of master franchisee applicants. In both countries EI has attracted experienced, mission-driven housing developers who hold advanced degrees in business and finance. Their interest in ECHALE suggests that the franchise offering is attractive. They are well-connected and respected business owners in their communities and have demonstrated their commitment to reducing poverty. In addition, local banks are interested in providing mortgage finance for homebuyers, while other local businesses have raised the possibility of collaborating to address the shortage of quality, affordable housing for their workers.

### **Conclusion**

In both developed and developing countries, social enterprises have played a valuable role in providing innovative solutions to a range of social needs, including affordable housing. A common challenge facing social enterprises is how to rapidly scale proven solutions, while maintaining what makes it unique; all within the constraints of the capacity of the management team. As social enterprises themselves, along with policymakers and the broader international development sector, seek options for scaling solutions in the face of these constraints, a franchise model should be considered.

Research into franchising already shows the conditions under which franchising can be an appropriate solution and provides lessons about how a franchise



structure can be effectively implemented. ECHALE International has used those findings and provides early evidence that a franchise model can successfully scale the impact of a social enterprise with a proven affordable housing solution. Its use of a joint venture franchisor and master franchisee agreement is an innovative approach that could be used more widely to scale local social enterprises internationally.

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