

## 062 UNLOCKING THE POTENTIAL OF FRANCHISING PARTNERSHIPS TO IMPROVE WATER SERVICES COMPLIANCE

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### ABSTRACT

*There is a need for institutional innovations aimed at increasing the coverage and reliability of water services, and sustaining those services, while improving compliance. This paper describes WRC development of an alternative institutional concept, viz franchising partnerships for the operation and maintenance of water services. It describes the formulation of franchise models that could be developed and made available to emerging entrepreneurs as the basis of viable businesses, and describes an environment to facilitate this, and how franchising partnerships would bring improved skills levels to bear at local level where needed.*

### BACKGROUND

The rapid rate of construction and commissioning of new water services infrastructure is severely challenging the public sector institutions responsible for operating and managing this infrastructure. Innovative approaches to water service delivery are required. But even if all the existing institutions 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, and/or
- could allow existing roleplayers to focus on their other responsibilities, and/or
- could offer a range of other advantages (including greater local economic development).

There is an alternative institutional model that is suited more for the ongoing operation and maintenance of water services systems than for investment in new infrastructure – and, importantly, that is friendly to small business and local economic development. This alternative is the franchising partnership. However there is little experience of this approach anywhere in the world, although some existing partnerships share some of the characteristics of the franchise approach.

The barriers to entry for the smaller or start-up company are substantial. But if these could be overcome – and franchising is a way to overcome them – then there will be many opportunities for improved water services and for local economic development. The twin driving forces of the franchising partnerships concept are the existence of a successful business model that can be copied widely (there have up to now been very few such models for the water sector<sup>1</sup>) and the profit motive.

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 key is the incentive, to franchisor and franchisee alike, to improve efficiency, and to provide improved service reliability and quality control.

A Water Research Commission (WRC) scoping study completed in 2005 (Wall 2005) found that franchising partnerships could alleviate and address many challenges in the management of water services. At the same time, franchising would support the development of local microenterprises and (broad-based black economic empowerment) BBBEE, all within the public sector service delivery environment. This was all reported upon at the 2006 WISA conference (Bhagwan et al 2006)

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<sup>1</sup> Furthermore, much of the business information pertaining to these very few models is, understandably, guarded by the companies that possess it, and which have, with little if any exception, gained their information the hard way – through experience! It is their competitive advantage, and they are willing to share only up to a point.

Ongoing WRC research has since then very much further explored and developed the concept of franchising partnerships in water services.

The WRC collaborated in this work with a team led by the CSIR and comprising in addition Amanz' abantu Services (Pty) Ltd and others.

## THE CASE FOR WATER SERVICES FRANCHISING PARTNERSHIPS

Franchisee water service providers, dependent for their livelihood on the success of their business, would have a strong incentive to perform, and would also enjoy the benefit of the franchisor's expert guidance and quality assurance. On this latter point, a franchisor can ensure a professional approach, quality control, and ongoing training, as well as advice and help when needed.

This help from the franchisor would be of particular value in water services authorities (WSAs) away from the major urban centres. Few of these WSAs can afford to employ competent qualified staff beyond basic skills levels, and surveys of their treatment works show frequent non-compliance with the performance standards laid down. (For one example only: Snyman et al 2006 <sup>2</sup>.) Significant improvements would soon be seen if the generally under-qualified or under-resourced water services staff in these WSAs could have this ongoing support, mentoring and quality control -- or if the WSA could enter into partnerships with microenterprises which would, through franchising partnerships, enjoy the necessary ongoing support, mentoring and quality control.

Given that the costs of the franchisor's higher levels of specialist expertise would be shared by several franchisees, the franchisor could afford to make this expertise available to each of them on an as-needed basis, and could provide other resources normally only available to larger water services providers. This holds significant benefits for WSAs.

Thus there is ample scope for the microenterprise private sector to assist, and there should be a range of ways in which entrepreneurship in water service provision can be encouraged and supported. If the microenterprises were not stand-alone, but were franchisees, they would enjoy competent franchisor support, and both franchisee and franchisor would be incentivised to make this arrangement work. Many useful pointers can be found in business format franchising franchisee development programmes as well as in engineering infrastructure contractor development programmes, both of which have good track records in South Africa.

The WSA client's competence to monitor performance and enforce contract compliance is key to it effectively using the microenterprise sector. However if an WSA is short of management resources, it would be putting these to more efficient use if it managed the work of the contractor rather than tried to cope with the operational issues itself.

The argument for franchising partnerships as a means to improve efficiency in water services operation and maintenance does not depend on the case for or against the participation of for-profit organizations. There are already elements of franchising partnerships in some of the current activities of non-profit water services organisations in South Africa. For example, a valuable asset to several predominantly rural WSAs currently is the practice of appointing large water services institutions as "support services agents" to support water services providers that are NGOs and small, local CBOs. Although this arrangement is not franchising, development of the franchising partnerships concept has learnt from it, and it could in turn benefit from adoption of some of the characteristics of franchising.

It is acknowledged that there are a few water services franchisors that have long been operating in South Africa. They are successful financially and in terms of the service (operation and/or maintenance of an element or elements of the water

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<sup>2</sup> "The root cause for the poor performance at the majority of non-compliant plants does not seem to be the need for additional or upgraded plant infrastructure or the need for additional funding. The challenge is that the available plant infrastructure and equipment are not well operated and/or sufficiently maintained." (Snyman et al pg 11)

In terms of resources, "some form of intervention is required with regards to the following:

- Capital infrastructure investment at 85% of the plants;
- Skilled operational staff required to operate the plant efficiently at 50% of the plants;
- Skilled maintenance staff required to adequately maintain the installed mechanical/electrical equipment and instrumentation at 56% of the plants;
- Financial resources to support the routine operation and maintenance at 21% of the plants; and
- Information resources required to properly operate the plants at 63% of the plants.

**The most pressing deficiency is the critical shortage of trained, skilled and experienced process controllers and mechanical/electrical maintenance staff." (ibid pg 4) (Emphasis added)**

services delivery chain) that they provide.<sup>3</sup> But they have not, or do not wish to, provide other elements, or provide their services to other than their current market niche (invariably private sector purchasers of their services). In more than one case, they would like to extend their services to WSA-owned infrastructure, but do not find the environment conducive.

A major motivation for the research has been the WRC's wish to break water services franchising out of its current niches, and to explore and pilot franchising's application across operation and maintenance of a range of public sector water services delivery elements. And to place in the public domain the business information (e.g. methods, financial viability) that it (the WRC) develops.

The WRC found that it is essential to the success of water services franchising partnerships that, *inter alia*:

- Service to customers meets the specification in the franchise contract with the WSA
- 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
- Funding partners support water services franchising partnerships 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 partnerships must benefit from the funding streams (e.g. the Equitable Share Programme) to the WSA to the same extent as these streams are intended to benefit any other type of water services provider, including the WSA itself.

## OVERVIEW OF WATER SERVICES FRANCHISING PARTNERSHIPS

The WRC has therefore been researching a partnership concept, making use of the principles of franchising, for improved water services infrastructure operation and maintenance. In this concept, ownership of the water services infrastructure remains with the public sector (e.g. the WSA).

The concept has been formulated with a view to improving water services operational quality and efficiency through introducing a new (to water services) supply-side operation and maintenance provider mechanism.

Many South African WSAs do not have staff or systems to deliver a reasonable service. A carefully designed set of WSA/franchisor/franchisee arrangements, efficiently implemented, could assist. At the same time, franchising offers opportunities to the microenterprise sector and to local economic development. Franchisees are microenterprises, but their association with a franchisor gives them considerable advantages -- reflected in the better service that they can provide -- over stand-alone microenterprises.

Franchising might not be ideal, but it might in many situations offer the prospect of improved operation and maintenance of water services. However three main priorities need to be addressed simultaneously if the operation and maintenance of public sector water services infrastructure is, in the cause of improved water services provision, and to the benefit of water services users, to be franchised where it is appropriate to do so. As follows:

- Ensure that the necessary steps are taken to allow the non-governmental organisation (NGO), community-based organisation (CBO) and microenterprise sectors to compete on even terms with in-house providers. At very least, this must be done where in-house operation and maintenance is showing obvious signs of serious or repeated non-compliance.
- Address funding stream and municipal financial stability issues.
- Ensure that a limited number of water services franchising partnerships pilots are up and running as soon as possible. These pilots will, through their success, demonstrate the potential of water services franchising partnerships.

National government is the key roleplayer in terms of addressing the first two of these priorities.

Research shows that municipalities are for the most part unlikely to change in respect of the first of these priorities. If, therefore, national government wishes to see change, it is going to have to demonstrate strong leadership.

Research also shows that many municipalities are not able of their own accord to bring about significant change in respect of the second of these priorities. Again, therefore, national government is going to have to take the leadership itself. In this instance, national government has succeeded in bringing about some improvement, but much more needs to be done.

A "three-step breakthrough" is needed:

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<sup>3</sup> For example, The Drain Surgeon is a well-known franchisor, based in Gauteng, but with franchisees under the same brand name in all major centres of South Africa.

- The first step is the breakthrough to acceptance by WSAs of outsourcing the operation and maintenance of infrastructure that they, the WSAs, own. (To emphasise: this outsourcing need not necessarily be to the private sector – it could also be to NGOs and CBOs.)
- The second is the acceptance that the institutions outsourced to could be microenterprises
- The third step is the acceptance that these microenterprises could be franchisees. (This third step should not be a problem once the second level is in place.)

Franchised microenterprises should be a concept considerably easier to convince clients of the merits of than the idea of microenterprises that are stand-alone.

Note that what is good or bad for microenterprises is good or bad for franchising partnerships. But the converse doesn't necessarily apply – or, putting it differently, a franchisee microenterprise, given the support it would receive from the franchisor, would in all likelihood find it easier to meet some regulatory and other requirements than would a stand-alone microenterprise, everything else being equal.

Finally, whereas a business based on a single element of the water services delivery value chain might not be viable, a franchisee might be able to make a viable business by offering several water-related services, thereby achieving dual objectives, viz:

- economy of scale; and
- lessening dependence on one or a limited number of clients.

The next section puts in a nutshell the case for a partnership concept, making use of the principles of franchising, for improved water services infrastructure operation and maintenance.

## **WATER SERVICES FRANCHISING: A PARTNERSHIP CONCEPT**

In the briefest possible terms:

- The WRC has found that a franchise partnership concept can assist WSAs with their water services responsibilities, specifically the operation and maintenance of infrastructure.
- The WSAs will continue to own the infrastructure.

Water services franchising is a means of:

- assisting WSAs by providing the higher-level expertise in water and sanitation infrastructure operations and maintenance that would very seldom if at all be found outside the metropolises and larger urban areas; while
- creating and supporting CBOs and small entrepreneurs who can provide locally-based and efficient service provider solutions; and
- building local economic development.

The concept addresses the lack of higher-level expertise that has so often been identified as a key to improvement of service, especially in the more remote areas. The local staff can deal with day-to-day operational needs, but are not able to deal with anything more demanding than that. The essence of water services franchising partnerships is the creation of a pool of appropriate expertise upon which the local operators can draw, a restructuring of the local responsibility for operating, and the creation of a two-way obligation -- an obligation to call for assistance from the pool, and an obligation to respond rapidly to that call. All of this together with the incentive structures to ensure that it happens. (For more detail, see first box alongside.)

The franchisees would be microenterprises and CBOs. The franchisors would be any institution that has the required expertise, is willing to provide the service, and would not be in a conflict of interest by providing the service.

An analogy would be a combination of:

- a WSA (or any other owner) purchasing a motor vehicle together with a maintenance plan (or purchasing the maintenance plan afterwards); and

**Through franchising partnerships, matching skills levels, and matching obligations, together with incentives to use the skills appropriately and effectively.**

- On most days at the (for example) treatment works, nothing extraordinary happens. Franchisee staff, who are lesser-skilled, are able to cope.
- When major maintenance or upgrading is needed, or when there is a breakdown -- those staff know who to call at the franchisor in order to bring the higher level of skill.
- And they know that the people they call WILL help, because there is a binding contract and a shared reputation.
- It is two-way obligation -- an obligation on the franchisee to ask for help, and an obligation on the franchisor to give the help.
- Cost of the higher skills levels, which are needed only intermittently, is spread across many sites -- thus cost per site is low.

- the maintenance is undertaken by a franchisee, with the continuous support of a franchisor.

The WRC has modelled the franchising partnerships of selected elements of the water services value chain. This modelling has drawn upon first-hand knowledge of operating these same elements in contexts as close as possible to franchising. It has also drawn upon understanding of the small number of franchises already active in the water services sector, and upon understanding of the very much larger number of franchises in other fields.

Finally:

- Franchising partnerships offers significant potential for improvement in services quality and reliability, greatly assisting the good functioning of WSAs.
- Franchising partnerships offer significant potential for the capacitation and participation of microenterprises and CBOs, and for BBEE.
- Whereas a WSA may require contractual recourse not only to the franchisee, but also to the franchisor, the franchisor could be a co-signatory to the contract or a guarantor of the performance of the franchisee.<sup>4</sup>

### The principles of franchising.

- Franchises' success is based on replication of success, efficient logistics and a trained and capacitated workforce.
- Franchisee small businesses are relatively easy to establish.
- Franchising is robust, and able to ensure consistent quality products and services.
- Franchisees are obliged to adopt the tried and tested systems and procedures of the franchisor, and to accept the quality control of the franchisor -- resulting in higher quality assurance and greater efficiencies.
- Franchises are able to innovate and develop constantly.

### WAY FORWARD

The way forward from now on lies only to a limited extent in more modelling. It lies rather in piloting the concept, and learning from the pilots. It also lies in creating a more conducive environment – comprising matters relating to funding and financial control, accountability, performance regulation, service standards, capacity, outsourcing policy, procurement procedures, and other issues.

This final section of the paper addresses, in order, modelling, piloting and advocacy designed to create a more conducive environment. How the themes of modelling, piloting and advocacy can support each other is described – for example how advocacy can (and already has in at least one instance) lead to an opportunity being perceived and resources being put together in order to commence piloting, and how the success with that pilot, once it is underway, will in due course strengthen the advocacy.

Whereas more research, and particularly the building of more **models** on paper would undoubtedly add great value<sup>5</sup>, the main need now is to start piloting the concept.

The on-paper studies have been taken to the point at which the concept is described and it is made sufficiently clear that it could work, where it could work, and how it would work. If the environment is favourable, potential franchisors will, it is hoped, seize the opportunity, and will do the detailed modelling to suit their abilities and the circumstances to which they see the concept being applied.

**Piloting** of the concept, after completion of the current study, is being promoted. Only in piloting will be benefits be demonstrated. Also, unanticipated challenges will be identified -- and overcome.

Proposals for piloting can readily be grouped into two types, as follows:

<sup>4</sup> Because of the essential services nature of water services, there might have to be a backup contractual relationship between the franchisor and the WSA. This would oblige the franchisor to take over the franchisee's responsibilities, even if temporarily, should the franchisee fail for any reason whatsoever.

<sup>5</sup> The WRC research has already modeled:

- A sustainable community-level caretaker management business;
- a sustainable schools and sanitation business; and
- a sustainable pressure control management business.

Other areas for potential franchising include leak detection, borehole management, management of municipal treatment works, management of treatment package plants, meter reading, pit-emptying services, laboratory services, data management, and site and property management.

- Proposals that would lead to the establishment of franchisee water services providers, offering a full range of water services. (Call these "Type A".)
- Proposals that would lead to the establishment of franchisees that would offer selected services under contract to water services providers ("Type B").

Preliminary planning of DWAF's "Water for Growth and Development" programme has identified that franchising partnerships would be a key element in its initiatives (still being evolved) to address the dynamics of water, growth, poverty alleviation, and development. Projects could be of either type.

There are already many potential sites for water services franchising partnerships, in the sense that much water services infrastructure is already in place but is not being operated properly at the present time. While these sites fall under the jurisdiction of or are owned by WSAs, and the reluctance to consider franchising, or even any significant outsourcing of operation and maintenance, of what appears to be the majority of WSAs has been noted by the WRC, it is encouraging that a sufficient number of WSAs appear to be willing to consider undertaking, or permitting, water services franchising partnerships pilots.

The sequence of events will probably be that franchisors will select water services elements and will formulate the business models to go with each. They will then look for sites to apply the models and will seek the cooperation of the WSAs responsible. Finally they will offer the business to potential franchisees, or will attempt to nurture potential franchisees. As water services franchising in South Africa grows, however, the initiative may come from others -- e.g. from the WSA, but to begin with it is highly probable that it will only be franchisors that initiate water services franchising partnerships proposals.

The franchise industry literature over and over again advises against franchising a business without a business model that has not been thoroughly worked through on paper and that has not been tested "in the field" over a period of time. As the FASA manual emphasises, by far the best way to test the model is by "actually operating the business .... [this] is the only reliable way" (FASA 2005 pg 60). This the franchisor should preferably do by for example running a directly-owned outlet that lacks only a franchisee and a franchise agreement, but has in place many of the other aspects of franchising -- e.g. there would need to be an operating manual, training, quality control, etc.

Further to that, FASA makes a strong case for doing the initial testing of the non-franchised business model in an area where, if the test result is positive, the first franchised pilot will be rolled out. This is the most direct way to establish:

- o local expertise (local management and staff) and
- o local familiarity with and confidence in the product (which in the case of water services should not just be confidence of the customers/end users, but of other stakeholders, especially of the WSA and of other WSPs).

As franchising partnerships spreads, business models will proliferate, and companies with the appropriate water services skills and resources will be attracted to the franchisor role.

For each potential franchising circumstance, a specific approach will probably be clearly enough evident at the time, and a pragmatic "horses for courses" attitude to franchisee selection will prove appropriate.

Two companies that have seen the opportunity, and are indeed "seizing" it, are Amanz'abantu Services and Biwater. Both have expressed interest in playing the franchisor role, and are advanced with investigations into how they can expand their range of operations into the franchising arena. In the case of both companies, their interest is in Type B.

Meantime, the WRC is not allowing its own water services franchising partnerships initiative to slacken.

Finally, a foreign donor has agreed to substantial funding for piloting and other work over the next three years.

Now turning to **advocacy**:

As noted above, a "three-step breakthrough" is needed. The WRC team is confident that this breakthrough will be achieved. It will take strong and insistent advocacy at both national and local level. Advocacy, that is, that lobbies key influence groups -- such as key personnel within lead departments of national government -- chiefly DWAF, the Department of Provincial and Local Government (DPLG) and National Treasury (particularly because of its influence on outsourcing and procurement policy) -- and within other bodies such as SALGA. Advocacy, also, that disseminates widely the findings of the research, and is able to encourage locally-driven initiatives.

Successful pilot projects will be of considerable assistance in achieving the breakthrough. At the moment, the understandable response of many is along the lines of "if water services franchising partnerships is all that you say it is, then why is no one else doing it?" There is a natural reluctance to embark on something other than the tried and tested.

The way into acceptance by the WSAs of water services franchising partnerships is:

- The WSAs need to see the benefits of utilising microenterprises, compared to trying to employ their own staff to do the work.
- As they cannot (in terms of their procurement policy) directly exclude non-franchised microenterprises, they need to understand the benefit of using microenterprises who are franchisees (above those who are not).
- For work requiring higher levels of skill, they can specify additional requirements for microenterprises as part of the job description (these are the differentiating qualities that will favour the franchisee above the stand alone microenterprises). Examples include, access to support of a technical financial or administrative nature, access to financial resources, specialist equipment, and a certified quality management system.
- When tenders are evaluated, the higher level of services, and of certainty and reliability in delivery, that are offered by the franchised microenterprises will count in their favour.

In support of this, and in order to create a more conducive environment so that more WSAs will be willing to consider outsourcing to franchisee microenterprises:

- WRC and CSIR need to step up advocacy to national government around the environment issues listed in the first paragraph of this section; and
- WRC and CSIR need to lobby for national government to proactively support microenterprise options, and particularly franchising options.

The motivation for this is not primarily derived from need for compliance with standards (such as water reliability and quality standards) or about infrastructure asset management. It is also derived from the attractiveness of the returns from improving operation and maintenance of water services infrastructure neglected by WSAs. These returns can be substantial – returns, that is, measured in terms of for example water loss reduction, improved wastewater treatment works effluent quality, and more reliable water supply. Funding that would enable the trying out of promising new ideas (and franchising of water services operation is one) would be money well spent.

National government should assist with focused initiatives to address funding stream and author financial liability issues. Potential franchisors are inhibited by the fear that, contractual commitments notwithstanding, WSAs may make payments late or not at all. No microenterprise can afford a delay of two or three months before it receives its due for services rendered, and it could go to the wall while it waits for payment by an inefficient financial department. Another issue is budgeting -- the microenterprise franchisee would need to contract not for the kind of budget that is so often allocated by a WSA to operation and maintenance, but would need to be paid from a realistic, adequate budget.

The several initiatives that have made use of supported CBOs (e.g. Mvula Trust (and others), and the "support services agents" themselves, have been facing some of the same issues. Their success (or otherwise) in achieving at local level the first step of the breakthrough should be observed – and indeed their ongoing efforts to get a fairer deal for outsourcing must be applauded.

In support of general dissemination of knowledge of the appropriateness and advantages of water services franchising partnerships, the advocacy programme (much of it ad hoc, seizing opportunities as they arise) of the WRC and CSIR must continue. The aim should be to draw attention of both the public and private sector to the advantages of water services franchising partnerships, and to elicit support for it from the public sector – in particular from DWAF and other key national government departments. Not just their in-principle support, either, but their active support for making the environment more conducive to outsourcing water services operation and maintenance, and in particular addressing the priorities identified above as to what needs to be addressed if franchising is to be viable and is to provide the desired service.

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