

**EVALUATION OF THE SUITABILITY OF  
STRATEGIC OPTIONS AT QINOS:  
FRANCHISE OR OUTSOURCE?**

(CONFIDENTIAL)

A Dissertation Presented to:

The Graduate School of Business

University of KwaZulu-Natal

In partial fulfillment of the Requirements for the  
Degree of

**MASTER OF BUSINESS ADMINISTRATION**

**UNIVERSITY OF KWAZULU-NATAL**

by

M O Mkhonza

January 2004

## DECLARATION

I declare that this research report is my own original work and all sources used or referred to are documented and recognised. This report has not been previously submitted in full or partially to any other recognised educational institution.

096978

---

Mdu Mkhonza

30 January 2004

## ACKNOWLEDGEMENTS

I would like to thank Prof. Elza Thomson for her assistance, time and advice. I would also like to thank my wife and kids for their help, understanding and support throughout my degree.

## ABSTRACT

The political processes with regards to black economic empowerment creates a very favourable business environment both for start-ups and already established black companies

The service industry is the fastest growing industry around the world. In South Africa, the demand for technically skilled technicians in the information and communication industry is huge.

The challenge facing most black start-up is the sustainability of these companies in view of changing economic, political, social and indeed technological environment.

Franchising has been hailed as the best business growth strategy in many countries and particular for black owned small businesses in South Africa. The Franchise Association of South Africa is the authority with regards to franchising in South Africa. The Association has developed detailed and easy to follow guidelines towards franchising.

Outsourcing non-core business activities enables a company to focus on its core business. Once a company focuses on its core business, it is then able to save on operational costs, focus on developing new products and offering better services.

Both business-format-franchising and outsourcing are not perfectly suitable for Qinos and/or sustainable in the long run. The recommended strategic option is outsourcing with a mentoring programmed embedded in the strategy implementation, herein referred to as the hybrid strategy. The hybrid strategy suggests the creation of a network of subcontractors to whom Qinos shall outsource some of its activities. The Subcontractors Network shall be a strategic alliance of field service providers in the ICT sector based in KwaZulu-Natal, initiated and mentored by Qinos. Qinos shall manage outsourced operations on behalf of companies that are outsourcing their field maintenance services, in the ICT sector, to these credible SMEs.

The Subcontractors Network are small, owner-managed black owned companies that can provide the basic infrastructure for running a field maintenance service in the ICT sector. They have the competencies or are able to acquire the vendor-required competencies within a short period of time not exceeding six months. They provide world-class service quality, are profitable and sustainable.

## TABLE OF CONTENTS

Declaration.....	i
Acknowledgements.....	ii
Abstract.....	iii
Table of Contents.....	iv
List of Figures.....	vii
List of Tables.....	viii

### CHAPTER 1: Introduction

1.1. Background Information.....	1
1.2. Motivation for Research.....	1
1.3. Value of Research.....	2
1.4. Problem Statement.....	2
1.5. Objectives of the study.....	2
1.6. Research Methodology.....	3
1.7. Limitations.....	3
1.8. Structure of the study.....	3

### CHAPTER 2: Literature Review

2.1. Environmental Analysis.....	4
2.2. Resource Analysis.....	9
2.3. The strategic options.....	10
2.3.1. Business Format Franchising.....	11
2.3.1.1. Options for expansion.....	13
2.3.1.2. Brief History of franchising.....	13
2.3.1.3. Financial Aspects of Franchising.....	14
2.3.1.4. Essential Legal Considerations.....	18
2.3.1.5. Mediation and arbitration.....	21
2.3.1.6. Regulations and protection.....	22
2.3.1.7. A successful franchise system.....	22
2.3.1.8. Key Psychological Factors.....	25

2.3.1.9. Advantages and disadvantages.....	31
2.3.1.10. Conclusion.....	35
2.3.2. Outsourcing.....	36
2.3.2.1. Introduction.....	36
2.3.2.2. What drives outsourcing.....	37
2.3.2.3. When to outsource.....	38
2.3.2.4. Structuring the alliance.....	39
2.3.2.5. Advantages of outsourcing.....	41
2.3.2.6. Risks and costs of outsourcing.....	41
2.3.2.7. Managing the alliance.....	42
2.3.2.8. Conclusion.....	43
2.4. Strategy evaluation.....	43
2.4.1. The suitability criteria.....	44
2.4.2. The acceptability criteria.....	50
2.4.3. Feasibility Criteria.....	50
2.5. Conclusion.....	51

### **CHAPTER 3: Qinos (PTY) Ltd – A Case Study**

3.1. Company background.....	52
3.2. The Service Sector - ICT.....	55
3.3. Monopoly cushion.....	56
3.4. Business Model and Strategy.....	57
3.5. Company Operations.....	58
3.6. Operational performance.....	59
3.7. Human resource management.....	60
3.8. Financial performance.....	61
3.9. Strategy review.....	62
3.10. Conclusion.....	63

### **CHAPTER 4: Strategic Options Evaluation**

4.1. Introduction.....	64
4.2. The business environment.....	64

4.3. Internal environment .....	66
4.4. The ideal strategy .....	67
4.5. Suitability criteria.....	67
4.6. Acceptability criteria.....	71
4.7. Essential differences.....	72
4.8. Conclusion.....	73

## **CHAPTER 5: The Hybrid Strategy**

5.1.Introduction.....	74
5.2.Hybrid strategies.....	74
5.3.Qinos hybrid strategy.....	75
5.4.Strategy Motivation.....	75
5.5.Strategy implementation.....	76
5.6.Legal Structure, ownership and financial structure.....	79
5.7.Management and personnel.....	81
5.8.Assumptions used in the business plan.....	85
5.9.Accounting policies.....	86
5.10. Discussion of Operations.....	87
5.11. Future growth.....	89
5.12. Conclusion.....	91

**List of figures**

Figure 2.1.....	5
Figure 2.1.....	25
Figure 2.3.....	36
Figure 2.4.....	43
Figure 2.5.....	46



**List of Tables**

Table 2.1 .....	5
Table 2.2 .....	8
Table 2.3 .....	45
Table 4.1 .....	63
Table 5.1 .....	80

# CHAPTER 1

## INTRODUCTION

### 1.1. Background of the research

Qinos (PTY) LTD, herein referred to as Qinos, is a small field service business based in KwaZulu-Natal and has two satellite offices in Pietermaritzburg and Richards Bay. Qinos is a fictitious name, as the name of the company has to remain confidential. The company's core business is the repairs, servicing and maintenance of electronic equipment in the field. An agreement is entered into between a specific vendor and Qinos regarding the field servicing and maintenance of their equipment. Qinos then pay for the training of its employees by the vendor. The vendor's clients log fault resolution calls with the vendor who then dispatches Qinos' technicians who in turn attend to and resolve the problem. Qinos currently has two such agreements. One is to service and maintain the national lotteries point of sales, the other contract is with Wireless Business Solutions to service and maintain their communication network equipment in KwaZulu-Natal.

On the 31<sup>st</sup> July 2003, the Board of Directors took a decision to investigate the suitability of the two strategic options, as proposed by managing director of the company, that would seek to improve customer service, business growth and a substantial return on investment for shareholders.

### 1.2. Motivation for the research

Qinos is a hundred percent (100%) black owned company established in 1999 by Uthingo Management (PTY) LTD as part of the national lottery license commitment to create a viable independent company that would be contracted to install and maintain Uthingo's network of Lotto terminals in the KwaZulu-Natal.

The long-term plan was that Qinos would use the service contract with Uthingo as a springboard to become a recognised Black Economic Empowerment (BEE) technology service and support provider in the KwaZulu-Natal.

The research is based on the premise that the technology change in the information and communication industry is given. Any small organization that seeks to stay longer in business and cope with such changes needs a flexible, innovative and cost-effective strategy to survive. The dilemma facing the decision makers needs to be resolved through a process of critically analysing the suitability of each of the options before adoption and implementation.

The recommendations made in this study can be adopted by other service providers, as their own blue print to black empowerment which is based on sound business principles accompanied by a well structured model of empowerment that does not compromise service quality and income generation.

### **1.3.Value of Research**

The research is meant to help the decision makers chose the most suitable strategy for implementation after a careful analysis of the environment and the challenges facing the organization. It is expected that the chosen strategy will have positive impact on the quality of service, customer relationship management and indeed on the shareholder's return on investment

### **1.4.The Problem Statement**

The management dilemma addressed in this study is the need to carefully evaluate strategic options available to the company before an option is adopted and implemented.

In this regard, the management at Qinos has a dilemma with regard to the most appropriate strategy to be adopted as they seek to differentiate and grow the business while at the same time use the strategy as a mechanism for empowering the previously disadvantaged blacks.

### **1.5.The Objectives of the study**

The objectives of the study are

- To investigate franchising as a means of differentiating, growing and creating business opportunities

- To investigate outsourcing as a means of differentiating, growing and creating business opportunities
- To evaluate the suitability of business format franchising at Qinos
- To evaluate the suitability of outsourcing at Qinos
- To recommend the most suitable strategy for adoption and implementation

## **1.6. Research Methodology**

The research for this study consists of two major sections: a literature review and a case study. The literature review reflects current and well-developed ideas on the topics of strategy evaluation, franchising and outsourcing. The case study reflects status quo at Qinos. It is a result of interviews with senior management and exploration of company documents which include minutes of the board of directors, service level agreement, shareholders agreement, some financial records, vision statements and field service performance records.

## **1.7. Limitations**

Although some financial documents were accessible, the financial records for the last three years were not made available. Thus the results of the financial projections and conclusions may not represent the true financial benefits that either of these strategies might bring to the company.

The interviews were conducted with the management staff, thus opinions and view of the board of directors are not reflected in this report due to the fact that they were not available for any form of interviews. General staff perceptions, inputs and comments were purposefully excluded from this study in order to avoid creating expectations and insecurities.

## **1.8. Structure of the study**

Chapter two contains the literature review on strategy evaluation, business format franchising and outsourcing. Chapter three cover the case study. Chapter four covers the evaluation of the suitability of franchising and outsourcing for Qinos. Chapter five concludes the study with the recommended strategy for adoption and implementation.

## CHAPTER 2

### LITERATURE REVIEW

The purpose of this chapter is to give some theoretical background to strategy development and evaluation. Various techniques are introduced and discussed. It is these techniques that will be used later on in evaluating the suitability of Qinos two strategic options.

#### 2.1. Environmental Analysis

The company's environment represents all external forces, factors and conditions that affect every organization's strategies, decisions and actions (Pitts and Lei, 2000). This includes customers, suppliers, distributors, government policy, social institutions and globalisation.

According to Lynch (1997) there are six basic environmental factors influencing the organization, viz. the general environment, factors affecting many industries, industry key success factors, the organization, the competitors and the customers.

In any company, new strategies have to be undertaken against a backdrop that cannot be guaranteed. The uncertainty associated with the business environment must be addressed as strategic options are developed.

This section examines some of the techniques used in environmental analysis guided by what is relevant for Qinos.

#### ❖ PEST Analysis.

PEST analysis is a checklist of the political, economic, socio-cultural and technological aspects of the environment. Some of the items that may be considered when undertaking PEST analysis, especially in the information and communications technology industry are mapped in figure 2.1. These items are not exhaustive, but as stated by Lynch (1997), 'Better to have three or four well-

thought items that are explored and justified with evidence than to have a lengthy ‘laundry list of items’. Table 2.1 depicts a simplified PEST analysis.

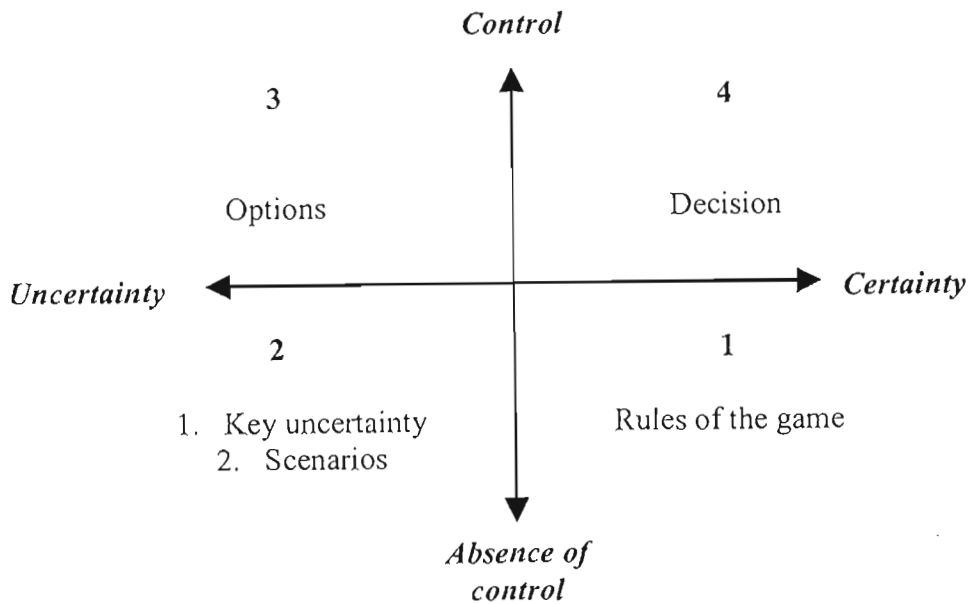
<p>Political Future</p> <ul style="list-style-type: none"> <li>• Legislation</li> <li>• Economic development</li> <li>• Government/industry</li> </ul>	<p>Socio-cultural future</p> <ul style="list-style-type: none"> <li>• Empowerment programmes</li> <li>• Shift in values and culture</li> <li>• Shift in lifestyle</li> </ul>
<p>Economic Future</p> <ul style="list-style-type: none"> <li>• Market size and growth</li> <li>• Industry profitability</li> <li>• Consumer expenditure</li> </ul>	<p>Technological future</p> <ul style="list-style-type: none"> <li>• Speed of change/adoption of technology</li> </ul>

**Table 2.1.** Simplified PEST Analysis

❖ **Scenario Analysis.**

Ilbury and Sunter (2001) state that the first issue to be identified during scenario planning are those aspects of the business that one can control and those that one cannot control. Next is to ask oneself about those aspects of the business that are certain and uncertain in the future. Based on these questions, then developed a matrix which can assist an organization to: (1) identify the rules of the game, (2) assess the key uncertainties, (3) paint scenarios, (4) evaluate realist options, and (5) thereby make effective decisions.

Figure 2.1. shows a scenario matrix.



**Figure 2.1.** Scenario matrix (Adapted from Ilbury and Sunter, 2001)

Opportunities and strengths belong to the lower part of the matrix since an organization cannot control opportunities and threats. On the other hand, strengths and weaknesses can be controlled and therefore belongs to the upper quadrant.

### **The rules of the game**

- Study the rules of the industry you are in, does it provide a real opportunity to make money?
- Does the organization have the natural ability to succeed in its chosen business sector?
- Understand that which the organization cannot control in order to understand what can be controlled.
- Identify the written and most importantly the unwritten rules that can cause success or failure.
- The rules of the game changes

## **Key uncertainty**

Uncertainties are those variables most relevant to a particular situation and possess the highest impact potential either as an opportunity or threat. The uncertainties are therefore the drivers in the design of possible scenarios. These uncertainties should be worked out and eventually eliminated down to the most vital ones. It should be remembered that these factors can be identified but they are outside the control of the organization (Ilbury and Sunter, 2001).

Through scenario formulation based on the rules of the game and key uncertainties, a vision on possible options can be formulated. Thus the bridging mechanism from uncertainties to options is through scenarios, which definitely have to be contrasting, vivid and underpinned by logic. A company's strategy comes from the company's perception of the business environment as well as the actual state of the market. The real impact on scenario planning should come from the perception of decision makers of the business environment.

## **Options**

A company can have a tremendous range of opportunities but limited options. Opportunities become options only when they fall within an organization's control. They are driven by uncertainties out of a company's control but they are restricted to actions under the company's control (Multhur and Keynon, 2001). A company that can exercise more options in the face of uncertainties has more power. For the power to last longer, the company needs to keep check on the changing rules of the game and to ensure that if they change, then the options must change too (Campbell et al, 2002). It is important that options are as effective as their implementation otherwise they are just good ideas.

It is important to note that options are not recommendations. An option or part of it can be used in recommendations and decision-making. Thus options give a company the comfort and certainty that the best decision was made under the prevailing circumstances even if in future it is proved to have been a wrong decision (Pitts and Lei, 2000). On the other hand, making decisions without options is very, very difficult since there is no choice.



## **Decision**

The decision-making process is a learning process involving experimentation and teamwork and the outcomes of decisions made may not be the expected or intended ones (Ilbury and Sunter, 2001). However, information and experience would have been gained that will be taken into account in refining the original plan and indeed, in tracking convergence or divergence between results and intentions. The greatest challenge facing companies is not in coming up with the best possible solution, but its execution.

An optimal decision making process, which invariably has an element of risk and are related primarily to the organization's ability to compete in the market (Lynch, 1997), should be based on the certainty of the outcome being realized, the resources available, a thoroughly worked through list of options to find the best way of implementing the decision and the realization that decision-making is incremental and is not made in isolation of other factors.

### **❖ Key success factors (KSF).**

Key success factors are those resources, skills and attributes of companies in the industry that are most pressing, the most important and the most critical to deliver success in the market place. These factors are related to the industry and are unlikely to provide differentiation between organizations in the industry. Thompson and Strickland (2003) view key success factors as the rules that shape whether the company will be financially and competitively successful. Table 2.2 shows some of the key success factors.

<p>Technology related KSFs</p> <ul style="list-style-type: none"> <li>- Scientific research expertise</li> <li>- Product innovation capability</li> <li>- Expertise in given technology</li> </ul>	<p>Distribution-related KSFs</p> <ul style="list-style-type: none"> <li>-A strong network of distributors</li> <li>- Low distribution costs</li> <li>- Short deliver time</li> </ul>
<p>Skills-related KSFs</p> <ul style="list-style-type: none"> <li>- Superior workforce talent</li> <li>- Quality control expertise</li> <li>- Expertise in a particular technology</li> </ul>	<p>Organizational capability</p> <ul style="list-style-type: none"> <li>- Superior information systems</li> <li>- Flexibility to shifting market conditions</li> <li>- Managerial experience</li> </ul>
<p>Other types of KSFs</p> <ul style="list-style-type: none"> <li>- Favourable image or reputation with customers</li> <li>- Overall low cost</li> <li>- Convenient locations</li> <li>- Customer guarantees and warranties</li> </ul>	

**Table 2.2.** Key Successful Factors (adapted from Thompson and Strickland 2003).

## 2.2. Resource Analysis

According to Lynch (1997), when analysing company resources it is not sufficient to draw a list of the main resources without developing an understanding of the way the organization operates, what its strengths and weaknesses are and how it can provide better services to customers and build its competitive advantage.

### The Winning Resources

Campbell et al (2002) define a competence as ‘an attribute or collection of attributes possessed by all or most of the companies in an industry. Without such competencies business cannot enter or survive in the industry’. They develop from resources and embody skills, technology and ‘know-how’.

The central question on resources is just what characteristics winning resources needs. According to Pateraf (Mathur and Kenyon, 2001), there are four winning resources, viz. they are distinctive, and have superior foresight, are matchless and inseparable.

Core competencies are a result of unique and distinctive ways that a company acquire, develop, integrates and utilizes its resources and competencies. Core competencies must be evaluated for customer focus, uniqueness, flexibility, contribution to value creation and sustainability (Campbell et al (2002)

### **The Value Adding Process**

Analysis of value adding activities helps identify where most value is added and where there is potential to add greater value by changing the way the company's activities are configured and by improving the way in which they are coordinated. However, the company's costs competitiveness depends not only on its value chain but also on costs in the value chains of suppliers and forward channel allies (Thompson and Strickland, 2003).

The analysis of the value adding process should include:

- A breakdown of all the activities of the organization
- Identification of core activities and their relationship to core competencies and organizational strategy
- Identification of effectiveness and efficiency of each activity
- Establishing the linkages between activities for additional value
- Identification of blockages that reduce the company's' competitiveness

### **2.3. The Strategic Options**

Once an analysis of both the external and the internal environments is done, a company is in a better position to decide on strategic options available. The assumption being made here is that

all possible strategies were explored but only two were short-listed for further investigation. In this section we explore both business format franchise and outsourcing in detail.

### **2.3.1. Business Format Franchising**

In America a new franchise is opened every eight minutes, this is a testament to the success of franchising which is predicted to soon account for 50% of all retail sales worldwide, making it a vital economic force and one of the dominant organizational forms of the current times (FASA, 2003). There is no doubt that franchising is gaining popularity throughout the world and is emerging as effective way to conduct and grow success businesses. The strengths of the franchise system is its flexibility and adaptability to suite every content, every life style and any socio-economic situation (FASA, 2003).

Franchising can best be described as a system of distribution whereby one party (the franchisor) grants to a second party (the franchisee) the rights to distribute products, or perform services, and to operate a business in accordance with an established marketing system. The franchisor provides the franchisee with expertise, trademarks, the corporate image, and both initial and ongoing support, in return for which the franchisee pays to the franchisor certain fees (Barber, 1997).

The objective is that both parties benefit from each other – the benefits to the franchisee include the goodwill that the franchisor has developed, the management and marketing expertise offered by the franchisor, and reduced costs of sales as a result of centralized bulk purchasing by the franchisor on behalf of all franchisees in the chain. The franchisor on the other hand benefits from the motivation of a self-employed franchisee (as opposed to a hired manager), from rapid expansion of a chain of outlets for his products without having to provide all the required capital himself (since the franchisee supply the capital required needed for their individual outlets), and from the franchisees' knowledge of the local market (Hall and Dixon, 1988).

Franchising works in the following manner (FASA, 2003):

The ownership by one of a trademark, service mark, an idea, a secret process, a patent or a specialized piece of equipment and the goodwill and the know-how associated with it.

The grant of a licence by that person to another allowing the use of a trademark, service mark, an idea, a secret process, a patent or equipment and the goodwill and the know-how associated with it.

The payment by the franchisee of a management service fee (royalty) in the nature of continuing fee for the rights, which are obtained, and for the services with which the franchisor will provide the licensee.

My definition

A franchise is a business growth strategy by a patent or service mark or trademark owner through granting of licences to entrepreneurs who in turn pays the licensor a management fee and is dependable on the licensor in the earlier stages of the business for training advice and support. The franchisee-franchisor relationship is governed by a contract and the franchisee is not totally independent from the franchisor.

There are different franchising options as defined by FASA (2003):

Product and trade name franchising – this is a sales relationship between the supplier and the dealer in which the dealer is granted the rights to sell the products in exchange for fees and royalties as well as obligation to sell only the franchisor's product. Petrol service stations, car dealerships and cool-drinks bottles dominate this type of franchising.

Business format franchising is what true franchising is all about. It is characterized by an on-going relationship between the franchisor and the franchisee and includes the product, service and trademark, but enables the franchisee to acquire the right to use the franchisor's entire business concept. This includes the franchisor's goodwill, products and services, marketing procedures, administrative and operative systems and support facilities (Pirtle, 2000)

### **2.3.1.1 Options for expansion**

In the Sunday Times Business Times (27 April 2003) it is reported that after a decade the US Department of Commerce's publication on South Africa, figures from the 2002 Franchise Baseline Census conducted by BMI-Foodpack to analyse the state of franchising in South Africa, indicate that the R135 billion franchising industry has indeed become one of the fastest-growing market in South Africa. The industry is also a strong contributor to empowerment. The report says 41.6% of all outlets opened in the 2001/2002 financial year were black owned, and that blacks now own 35% of all franchises in existence for over 20 years.

It is therefore important that franchisor's must not be allowed to sell an untested business concept. Furthermore, the objective should not be to sell as many franchises as possibly, but to sell a business concept that has been proven to viable.

### **2.3.1.2 Brief History of Franchising**

Early records show that a simple form of franchising was used in China around 200 BC. Subsequent known references to franchising can be traced back to the 11<sup>th</sup> century England, in the form of franchises granted by the monarch, which entitled his barons to administer tracks of land and collect taxes. Part of the proceeds had to be paid over to the monarch and this led to the coining of the term 'royalties' (Illetschchko, 1995).

The Singer Sewing Machine Company is among the early days pioneer of franchising as we have come to know it today (Pirtle, 2000). Singer was quick to realize that in order to continue to to build their market share, they needed to move closer to their customers. In turn this would require the creation of a vast network of distribution channels and service outlets over a short space of time. They were reluctant to make the necessary investments in opening new branches all over the show and to take on the management challenges associated with such a move. Thus Singer granted independent entrepreneurs, who has the suitable infrastructure in place, the right to stock and service Singer's range of products within their respective territories. In return for territorial exclusivity, the entrepreneur undertook to stock the entire range of machines and a full compliment of spares as well as the responsibility of servicing them (Illetschchko, 1995).

This strategy ensured that Singer and its franchisees operated in a mutually advantageous relationship. Singer offered the products, spares and some marketing support while the franchisee provided show rooms, financed local stock holdings and maintained the local infrastructure to enhanced, in the eyes of the customer, Singer's status as the world's leading brand in this field. Singer continues to operate in this fashion to this day and do not seem to be looking for a better strategy.

Top management from other industries observed this form of expansion strategy with keen interest. The motorcars industry soon discovered that its needs were similar since they too wanted to distribute motor vehicles through a network of franchise dealers. This strategy soon became the accepted practise in the motorcar world. Oil companies soon followed suit. The soft drink companies followed them. All these companies operated what would today be defined as the product franchise. Pirtle (2000) says that in 1999, franchising accounted for more than 35 percent of all retail sales in the United States of America.

Modern day franchising has seen an explosive growth in franchising that was triggered by two factors (FASA, 2003, 3):

- Consumers becoame more service oriented causing the marketing to focus away from product offerings to efficient distribution and service excellence
- People who had money but little or no business experience wanted to join the ranks of the self-employed and were prepared to pay for a blue print that would guide them towards business success.

The business format franchise has expanded into non-food industries, especially into the emerging service industry as a whole.

### **2.3.1.3. Financial Aspects of Franchising**

Haan (2003, 20) says: 'The development of a business from a proven concept to the sale of its first franchise is typically a long, expensive and risky process for the franchisor' The franchisor bears sizeable upfront costs for developing a business concept and running a pilot program before it can be marketed.

The initial franchise fee is normally paid as a single lump sum at the time when the franchise contract is signed. The initial franchise fee is supposed to cover the costs incurred by the franchisor in setting up a new outlet, and include the following:

- The costs of developing the franchise manual
- The costs of developing the accounting system
- The costs of site selection
- The costs of initial training provided by the franchisor
- The cost of marketing the franchise
- The costs of initial advertising and promotion for the launch of the franchisee's individual outlet
- The professional fees and legal costs
- Travel and accommodation
- The franchisor's own time (Hall and Dixon, 1988).

#### ❖ **Royalties or mark-up?**

A franchise is granted, never sold. The franchisor will always retain the ownership over the name, trademarks, patents and a host of many things associated with the franchise. The most important item owned by the franchisor is the 'intellectual property package', which is made available to the franchisee for the duration of the franchise agreement, subject to certain conditions and return for initial and ongoing payments. The franchisee on the other hand, invests his capital into the business and assumes full business risk and owns the 'local business infrastructure' (Illetschko, 2000).

In summary, the responsibilities are as follows: The franchisor develops the concept, builds the brand, develops the initial franchise package and provides ongoing support. The franchisee makes the initial investment, pays ongoing fees, adhere to the system and help to build the brand.

In order to set an appropriate level for initial franchise fee, the franchisor must be in a position to estimate all the costs he will incur in developing the franchise network. It is important to note that initial franchise fees should not be excessive since the franchisor will receive his earning from continuing royalties.



The franchisee will be required to pay some form of continuing fee to the franchisor in addition to the initial fee. This continued fee is intended to reward the franchisor for continuing management advice and assistance that he provides. The continuing fee is regarded as the main source of income for the franchisor. The continuing fee can be paid in one of two ways:

- A management service fee or service charge

This is the most common continuing fee paid by franchisees. It is a fixed percentage of the turnover. The franchisor must make three forecasts on turnover that might be achieved – pessimist forecast, realistic forecast and an optimistic forecast. The pessimist forecast can then be used as the basis of determining the royalty percentage. As a guide the percentage is set at a level that will allow the franchisee to earn a return of say 20 percent on his investment. On the other hand, there is a widely quoted rule of thumb that regardless of all permutations, the management services charge should not exceed 10 per cent of turnover (Hall and Dixon, 1988). Gordon (2003) supports this fact and estimates the average royalty to be eight percent (8%) of turnover.

- A mark-up on materials purchased from the franchisor

As an alternative to the royalty fee, a franchisee may be required to purchase all of his materials and supplies from the franchisor himself or from preferred suppliers. In this arrangement, the franchisor generates his income by adding mark-up to the goods purchased by the franchisee or alternatively receives a commission from the nominated suppliers.

Advantages and disadvantages

- In the management service fee method, the franchisor must ensure that the franchisee declares his entire turnover to the franchisor. The obvious temptation for the franchisor is to under-declare his turnover and as a result reduce the management service fee payments that has to be made. The mark-up method avoids this problem since the franchisor's margin is included in the price of all materials purchased by the franchisee. Thus the management service fee system needs extensive policing through the use of appropriate control system like unlimited online access to the franchisees sales records.

- The management service fee system dictates that the franchisor must sign a cheque or process electronic transfer of funds to the franchisor. The franchisee might come to resent the payment of these fees claiming that the franchisor's role is no longer significant and thus unbefitting of the service fee.
- The use of mark-up may lead to a feeling that the franchisee is being exploited by the franchisor, especially if the franchisor does not disclose what percentage is added as mark-up. Thus the mark-up system can be the basis for mistrust. Since the business relationship in a franchise is based on mutual trust between the two parties, a situation of mistrust will definitely lead to declining relations. The problem is compounded by the fear that the franchisor can raise prices at will. It is for this reason that the royalty fee is widely used.

The consideration that overrides all others is that in line with the spirit of franchising, business risk should be shared equally between the franchisor and franchisee. Thus if business is bad, both parties must be affected and vice versa. The spirit of a 'win-win' relationship is the essential prerequisite for the long-term success of a franchise system (Illetschko, 2000).

Franchising is about making money. The establishment of a franchise network requires substantial resources. Franchising has been proven to be the most economical way of expanding through a national or international network operating under one name and in accordance with the franchisor's set of system and procedures.

Sandamela (2002) points out that bankers look favourable at franchised businesses since the newcomer receives a proven blueprint, training and continued support and therefore stands a better chance of making success of it than an independent entrepreneur who is forced to learn by trial and error. It may well be possible that a financier may well consider the formation of a joint venture with a reputable franchisor. The financier may be able to provide tailor made package deals to franchisees, which comprises money plus administrative expertise. It is therefore important to always consider how the cake will be divided (i.e. per Rand) amongst the franchisor, the franchisee, the investors, the employees and the suppliers.

#### **2.3.1.4. Essential Legal Considerations**

Gonzaga (2003): ‘Since law in South Africa does not regulate franchising, the ethical standards of each person in the franchisor organization will determine the fairness, openness and honesty with which they do business in general. Ethical franchising boils down to whether you trust the people and believe they have your interests at heart’

##### **❖ The Franchise Agreement**

‘ The franchise agreement is the legal contract, which sets out the arrangement between the person buying the franchise (the franchisee) and the person selling the franchise (the franchisor)’ FASA (2003). Amongst other McGregor (2003) says that the franchise agreement should incorporate essential elements on which the relationship is based.

##### **❖ What is in a contract?**

The contract is a legal commitment, which is binding to both parties. A franchise contract has to take into account a number of different considerations. Amongst other things, it sets out the rights and obligations of both parties, defines the length of time the arrangement will last, stipulates the territory and the details of the costs involved.

The franchise contract must take into account the other franchisees (who must maintain same standards) and the customers (whose buying habits are influenced by brand image) and must be the most important element of a successful franchise relationship. A contract may be rendered illegal, unenforceable or terminated on a number of grounds, including breach, repudiation, performance, release, notation, prescription, etc. It is therefore important that the franchise agreement is carefully formulated in accordance with legal requirements (FASA, 2003)

##### **❖ Elements of the agreement/contract (FASA, 2003)**

###### **○ Description of a franchise**

The contract must outline briefly the nature of the franchise, its operations, trademarks, copyrights and know-how.

- Duration of the contract

The duration of the contract should be long enough to allow the individual franchisee to amortize/recoup the initial franchise investment. Since franchise contracts are offered for a uniform period in the chain and the period designed to ensure amortization, the parties may just as well adopt a contract that balances the interests of both parties. The conditions relating to the renewal of the contract should be clearly specified in the contract. A contract must be subjected to national laws governing restraint of trade.

- Territorial rights

The contract should state the territorial rights granted to the franchisee and the periods or conditions under which these rights may be changed. In order to prevent poaching of other territories by franchisees, each franchisee shall be expected to restrict his operations in the designated territory.

- Initial and continuing fees payable by the franchisee

All amounts that the franchisee has to make for the granting of the rights to operate a franchise should be stated. The level of the initial fee should be stated, along with a description of exactly what the franchisee will receive in return for his fee. The initial fee is normally paid before the franchisee commences trading. The timing of all payments should be specified and clearly stated if these are VAT inclusive or exclusive. The level of royalty fees must be stated along with the method that the royalty fee is calculated. The franchisor shall reserve the rights to check on the validity of sales information supplied by the franchisee.

- Contractual obligations of the franchisor

The provision of a business 'blue print' to be used by the franchisee. This will include methods of operation, trademarks, trade names, standards, how these standards are to be enforced.

- Contractual obligations of the franchisee
  - To preserve the element of trade secrecy which is associated with the franchisor's particular methods of operation.
  - To contribute periodic amounts that must be set aside for investment in the modernization premises and the upgrade of equipment so as to make the business continually attractive to customers.
- Termination of contract by either party

It is important that the circumstances under which the contract can be terminated are clearly spelt out in the agreement. The obvious reason for the termination of the contract is failure to comply with the terms as stated in the contract. The franchisee should also have the right to terminate the contract under certain specified conditions. Each party must give the other a reasonable time to rectify any breach. The rights of each party subsequent to premature termination should be explicitly defined in the agreement. Financial penalties, if any, that either party may suffer must also be specified.

- The franchisees right to assign the business

The franchisee must have the right to assign his business to a third party subject to certain controls imposed by the franchisor. Usually, the franchisor has the veto powers over the sale of the business to an individual who is unsuitable as a franchisee.

The agreement should also make provision for the sale or take over by the family, in the event of the franchisees' death. It is a common practise for a franchisor to manage the business until a suitable replacement has been found and trained.

### ❖ Code of Ethics

The great franchise ethics debate has taken the centre stage. The relationship between the franchisor and franchisees is based on trust. Bragg (2002) says that without ethical business

practices the trust evaporates and the business goes into decline. The character of the franchisor does count as it forms the corner stone for differentiation and the building of fruitful relationship with business partners.

#### ❖ Value Systems

Some common values that are becoming prominent are trustworthiness, respect for one another, responsibility for ones action, and good citizenship. Trustworthiness is very important in a business relationship and simple means (FASA, 2003):

- Acting according to stated values
- Standing up for their convictions
- Honesty and transparency in business dealings

#### 2.3.1.5. Mediation and arbitration (FASA, 2003)

- The Franchise Association of South Africa offers a mediation service designed to help resolve problems between the franchisor and franchisees without litigation or publicity or the intervention of a third party. This service is free and confidential, and is entirely impartial and deals with both franchisor and franchisee in equal fairness.
- Both parties must have exhausted all proper communication channels before mediation is considered. Both parties must agree to institute a mediation process. Mediation is aimed at seeking consensus.
- In the event that the mediation process fails, the parties are free to arrange for arbitration. Unlike in the mediation process, arbitration is not consensus seeking, the decision of the arbitrator is final.

### **2.3.1.6.Regulations and protection**

The structure of the franchise agreement can impact heavily on its tax efficiency. Tax regulations are subject to change from time to time. It is therefore of critical importance that the cooperation and advice of the company attorney and accountant be sought in order to create an optimal situation, tailor-made for the company's specific circumstances (Engelbrecht, 2003).

Intellectual property is the cornerstone to successful franchise concepts (Getz and Hessian, 2003). An important consideration is that company's intellectual property rights and trademarks should be adequately protected and properly registered. This is different from registering the name of the company, which does not enjoy any protection whatsoever.

The franchise agreement should seek to strike a balance between the franchisor's rights and obligations to those of franchisees. Although such a balance is desirable, the franchisor's rights must be stronger in certain respects in order to facilitate control, necessary for long-term success.

The legal implications associated with franchising are far reaching. It is important for any aspiring franchisor not to cut corners in preparation, drafting and signing a franchise agreement. Services of lawyers who specialise in franchise agreements must be enlisted.

### **2.3.1.7.A Successful Franchise System**

Running a successful franchise is quite a challenging and potentially dangerous task unless the franchisor gets some good professional help. Failures are common in the franchise world. Studies have shown that 76% of new franchises, which were tracked over a 12-year period in the US, failed (Illetschko, 2000, 35). Despite this figures, franchising still remains the most effective tool that when applied correctly, it can ensure success. Here are some of the features of a successful franchise system:

- Superior Leadership

Unlike normal businesses, franchising is unique in that it strives for a 'win-win' solution and not the 'dog-eats-dog' approach. Thus running a franchise does require a person who has the vision,

who sets targets and work hard at achieving them, a person who derives personal satisfaction from working in a team environment guided by common rules, a person who can motivate, direct and share knowledge, a person who leads by example and all other supplementary leadership qualities.

- Outstanding Relationships with franchisees

The prospective franchisees must believe that they can succeed with proper guidance and support. The franchisees must receive the full franchise package, including all necessary systems needed to operate, manage and control the business, help with regard securing the key staff, training and preparations for the grand opening. On an ongoing basis, franchisees want assistance in resolving their problems, to be treated honestly and with respect and being singing praises and being constructive in criticizing. The franchisees must understand the franchisor's expectations and vice versa. 'The success of each party is inextricably interwoven' (Sommerville, 2003, 61)

Just like in any marriage, there are problems that develop in the franchisor-franchisee relationship. Both parties in the marriage have expectations, desires, and goals. It is where these overlap that the franchise relation is based on. However, unlike in most businesses, the relationship between the franchisor and franchisee is a very special one and is different. In many instances such problems are undoubtedly associated with the level of motivation and satisfaction of the franchisee (Hall, 1988).

- A Well Developed Franchise Package

At the centre of any franchise system, there is a business concept that has been tried and tested by the prospective franchisor for at least a year. In order to transform the business concept into a franchise network, it is important to prepare the franchise package that must be in place on order for the franchisees to be successful in their businesses.

- Realistic Franchise Plan

The plan serves as a guide to successful franchising. It is a representation of a logical thought process that is frequently referred to and used as a blueprint for success. It is used to motivate



bankers, financiers, suppliers and prospective franchisees to support the business. It also becomes a measurement and evaluation tool used to determine whether goals have been met. It can also highlight future problems and opportunities.

Although there is no plan that can be guaranteed to be successful, the odds can be improved through the drafting of realistic business plans (Fouche, 2003). It is therefore important that the franchise plan is future focussed, achievable, team focussed and flexible.

- A Product with a Competitive Edge

The franchisor must determine if there is a gap in the market for the products or service he wants to offer. Is it a product developed for a particular niche market or mass market? The chosen market should have a potential to grow and be sustainable over time.

Does the product have a known trademark that has been registered and protected against copying? Does the product have a brand identity that can differentiate it from its competitors?

The franchise should be based on a proven system and procedures, well documented and easy to understand and implement.

- Dedicated Support Structure

- Head office staff -The franchisor must have dedicated, self-motivated staffs that have a good understanding of franchising and most importantly a display of team spirit and a positive attitude to life in general. Key staff personnel must include a franchise manager, who initial is the founder of the company; the field service officer, who understands the operations of the business, posses good communication, motivational and training skills; administrator, to ensure the smooth running and coordination of the head office activities.
- Use Professional Services -It is important that a franchisor realize that being a franchisor is tough and the operational problems arising from building the network can be nerve breaking for those who over estimate their capability. It is therefore appropriate that from time to time the franchisor must take a step back

and move away from the franchise in order to seek advice and professional help. These services can be expensive, however they are much cheaper when compared to the cost of ignorance.

- Franchise Attorney – The franchise agreement is complicated since it deals with a variety of different matters that are interrelated. For an example, the franchise agreement must accommodate genuine interests of both parties. In view of the fact that there is no specific law governing franchising, it is important that any attorney hired by the franchisor should have a good practical understanding of the franchise relationship.
- Franchise Accountant - The franchise accountant should be involved in the preparation of the whole franchise package in order to be able to help in the drafting of the financial projections and the design of financial control systems. The accountant should also help address prospective franchisees' questions with regard to the financial projects and be available for financial advice to franchisees during the operation of the outlet, especially during the first few months after opening.
- Franchise Consultant - There is a wide range of services provided by consultants these days. Consultants can help a franchisor with services ranging from feasibility studies, preparation of franchise packages and even marketing and selling the franchise (as long as there is no conflict of interests). Consultants must be carefully selected.

#### **2.3.1.8.Key Psychological Factors**

It is important therefore to understand some of the key psychological factors that are at the core of motivated and satisfied franchisees (Hall, 1988):

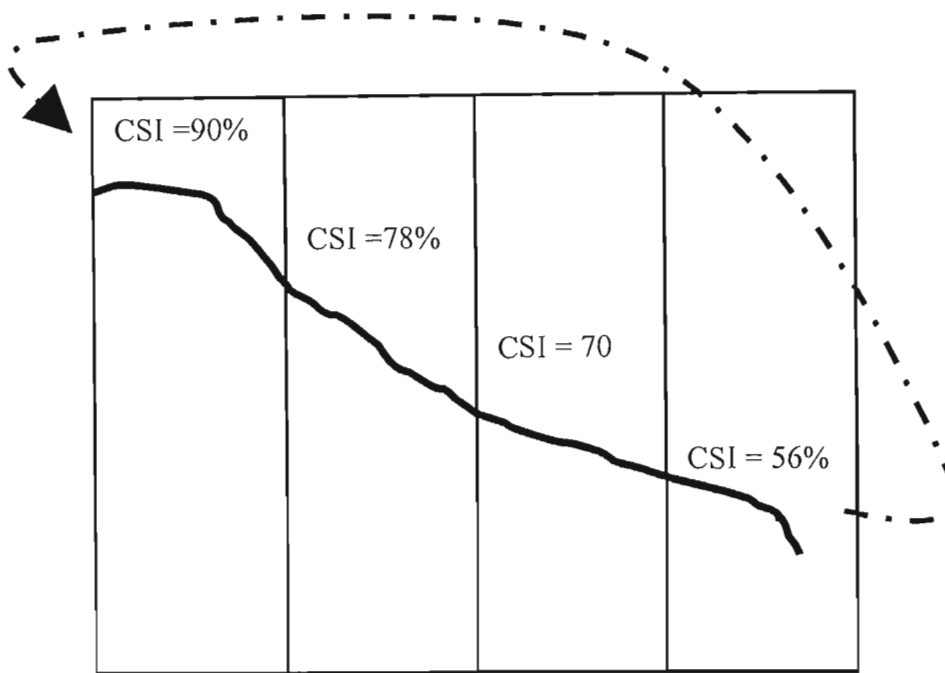
- Satisfaction derived from the preparedness to take limited risk – a person who is prepared to take some degree of risk may well find that he would enjoy the satisfaction of running his franchised business and therefore avoid the insecurity associated with being totally on his own.
- Satisfaction derived from being part of a team yet working alone – a person who is neither a loner nor a peoples' person. He derives satisfaction of working on his own as long as he enjoys a sense of belonging to a larger group.
- Satisfaction derived from the nature of the job and recognition of effort – the person is attracted by the idea of moderate autonomy, power and achievement.

The franchisee dissatisfaction needs to be understood within the context of the franchise life cycle concept. The satisfactory experiences of a franchisee are normally short-lived. It is therefore important from a franchisor's point of view to fully understand and anticipate the causes of franchisee dissatisfaction so that necessary steps can be taken to either prevent it or implement a programme to deal with it when and if it arises.

One of the most common causes of dissatisfaction stems from the fact that, many franchisees, once they have tasted some form of success they then begin to resent the continuing control exerted over them by the franchisor. It is for this reason that an understanding of the franchise life cycle is vital in understanding and dealing with franchisee dissatisfaction levels.

### ❖ The Franchise Life Cycle Concept

According to Parker (2000), the franchise life cycle was investigated in a National Franchising Research study. The franchisee satisfaction levels were represented in each of the four life cycle stages of the franchise life cycle concept (FLC). The following discussion is based on the concept as outlined by Parker.



CSI = Customer Satisfaction Index

*Figure 2.2 -the Franchisee Lifecycle Concept (Copyright: Consulta Research)*

*Phase 1: the Courting Phase (Duration of one year) – The first phase in the franchisee lifecycle is like a honeymoon period for a couple that has courted each other and has just married. It is exciting; both parties are very happy with the relationship and are excited about the future. It is the initial learning period; there is heavy reliance on the franchisor for training and assistance. The highest levels of franchisee satisfaction are recorded in this phase and the average likelihood of franchisee retention in this stage is 80%.*

*Phase 2: the “We”-phase – During the second year of the franchisees’ existence, the franchise lifecycle enters the “We”- phase that will typically last for another year. In this phase, the franchisee will still value the co-operative relationship with the franchisor and will work hard to make the most of the business relationship. The franchisee becomes familiar with systems and methods. Franchisor’s involvement on a day-to-day basis becomes less and less, however he still exerts control. It is evident that the franchisee satisfaction already deteriorates, due to possible doubts, relationship conflict, and significant to note that the average likelihood of franchisee retention decrease to 66% during this phase.*

*Phase 3: The “Me”-phase* – After approximately 24 months the franchisee will start to question the reason for royalty payments and generally would regard the success achieved up to date to be purely of his /her own hard work. The franchisee resents continuing franchisor control and royalty payments. Franchisee may even consider selling and opening his own independent business. The franchisee feels that he has done it all on his own. The relationship with the franchisor deteriorates even further and franchisee satisfaction decreases another few percentage points. The average likelihood of franchisee retention now stands at a low of 47%.

*Phase 4: The Rebel Phase* – In year four of the franchisee lifecycle the rebel phase is characterized by further questioning of the restrictions placed on them by the franchisor and a need for more independence. A more entrepreneurial franchisee will end up in this phase much quicker than is supposed to and most likely start his “own thing” (approximately 5% of franchisees will definitely end the relationship). If the progress to Phase 4 is on its natural duration, it is interesting to note that the average likelihood of franchisee retention now recovers to 73%. This is probably due to the fact that most franchisees that made it after four years are preparing for contract renewal in year five, where the courtship of contract renewal will again take the relationship back to Phase 1 of the FLC.

The franchisor expects the franchisee to be loyal in good and bad times, conform to standards, and communicate constructively, owner in charge, payment of royalty fees, positive attitude and enthusiasm.

The franchisees expect the franchisor to offer a tried and tested business format, strategic direction, good franchisee selection criteria, strong branding, training, marketing, new product development, maintain standards, good communication and motivation.

#### ❖ **Strategies to avoid dissatisfaction**

- Franchisee selection – the starting point in avoiding a build-up of excessive dissatisfaction lies in the careful initial selection of franchisees. The potential franchisees need to be suitable candidates who has personal drive and passion yet not too independent since they would

begin to resent control by the franchisor. They should be willing to work hard and be motivated by profits and customer satisfaction.

- Operational support – Franchisees must be provided with fully functional and efficient methods of operation covering all aspects of the business. Fullerton (2003) says that regular calls to franchisees need to be made to maintain motivation. A meeting every two months with all members of the group must take place to update them on the latest developments, discuss issues and resolve potential problems. A distinction is made between the initial and ongoing support. However, in real terms, in order for the franchisee support to remain effective throughout, the changing expectations of maturing franchisees must be taken into account and accommodated. A distinction has to be made between those franchisees who have been in business for a number of years to those who have been in business for less than a year.
- The franchisee life cycle discussed earlier, shows that there is a nasty phase of rebellion and mistrust somewhere between the initial engagement and the final acceptance. The life cycle should therefore serve as a guideline for the franchisor in terms of tailoring the support services required at this stage by the franchisee. The support services must be adjusted to keep pace with the franchisee's personal development. The franchisee must continue to receive tangible evidence of the value of the system and the franchisor's genuine interest in his welfare.
- It is important to note that too much support can be bad in the sense that it can create dependency and comes at a huge cost. Troubleshooting and guidance is part of the franchisor's duties, however running the day-to-day activities of the outlet is the franchisee's direct responsibility
- Communication structures - A joint consultative committee, consisting of both franchisee and franchisor representatives, is one way of limiting or avoiding dissatisfaction. The objectives of such a committee must be explicit and its sole purpose must be to enable a two-way communication and consultation on mutual concerns. Wimpy has a very effective communication strategy through the Franchise Council (Hele, 2003)

There is no doubt that for franchisors to be successful in dealing with franchisee problems they need to recognize and anticipate the problems associated with franchisee dissatisfaction. There is a need to establish effective franchisee-franchisor relationship, which is based on personal contact with individual franchisees and the implementation of an open door policy. The relationship between the two parties is a two-sided affair and each party must be prepared to take into account the changing and demanding needs of the other – the relationship should be that of mutual respect, trust and togetherness.

The franchisor-franchisee relationship must be a professional one. Good relations do not occur spontaneously, they flow from conscious effort of both parties that work to enhance the relationship. No franchisor should allow a franchisee to under-perform in the interest of nurse fragile relationships.

There are instances where franchisees require disciplinary measures to be taken against them. Illeetschko (2000) categorizes problematic franchisees as: the helpless ones, the mavericks, the bad payer and the chronic latecomer. The helpless ones are too lazy and they expect support from the franchisor on almost everything. Such franchisees must either take hand-on responsibility or consider retirement and quit the franchise.

Each individual in the franchise network is different and behaves differently. It would be naïve therefore to think that franchisee dissatisfaction could be eliminated completely.

#### ❖ **Attracting the suitable candidates**

Franchisors need to sharpen their recruitment skills in order to attract top prospects and therefore achieve success in the long-term. In franchising, if a person is willing to put forth the effort, then the person can enjoy tremendous success.

- The willingness of a prospective franchisee can be determined through some form of financial commitment that a franchisee must make when buying the franchise and therefore taking some risks
- Success is directly associated with the effort the franchisee puts in the running of the business. The effort can be measured through meeting service levels, taking initiatives by being pro-active, problem solving and being part of the family - team player.

Franchisors can follow any approach in franchise selection. One of the approaches that franchisors have found to be useful is the five-step approach (Illetschko, 2000):

1. Generate enquiries about the franchise
2. Set up the follow-up procedures in motion
  - a. Keep records of prospects and respond promptly to enquiries
  - b. Maintain consistency by drafting a checklist and standard scripts to be covered
3. 'Over-selling' must be avoided – during the courting period, leave the initiative to the prospect
4. Enter into concrete negotiations – encourage the prospect to discuss the disclosure document, financial projects and franchise agreement with his advisors while ensuring that the information does not fall onto the hands of established or potential competitors
5. Close the deal – sign the franchise agreement, bank the cheque and draw up a training/start-up/opening schedule.

#### **2.3.1.9. Advantages and disadvantages**

Harcourt-Cooke (2003) says that franchising is a wonderful, relatively safe business model for inexperienced people to operate their own businesses. However, fundamentally and ultimately the business model of the franchise business must work. The franchisee must make excellent returns on his investment and payments to the franchisor must be substantially lower than operating profits otherwise the relationship will fail, irrespective of goodwill between the parties. The role of the franchisee in operating the business to lay down specifications needs to be carefully monitored by mentoring new franchisees. Strict franchisor control of the image and standards of the franchise is essential to maintain the integrity of the trademark.

The benefits of franchising are numerous. The major constraints normally faced by SMEs are adequately addressed by franchising. Franchising plays an important role in providing entrepreneurs opportunities to be 'job creators' as opposed to job seekers; it also contributes immensely to the development and transfer of skills. The transfer of skills is particularly vital to the success of the emerging entrepreneur and therefore serves as an economic stimulant. By definition, business format franchising is a blue print to business success. However, the success



to happen, the franchise must be conducted in accordance with a series of well-defined guideline and ethics as provided by FASA.

❖ **Advantages to the franchisor**

- Rapid business growth can be achieved without having to borrow funds or to raise additional equity finance since franchisees will have to provide the start-up capital and initial running costs. Thus franchising can be used to develop extensive market share with less internal capital when compared with opening company owned outlets.
- A franchisor can use the franchise system in order to spread the unavoidable risk that arises in any major expansion programme. If company outlets are opened then the risks associated with failing sales and profits shall be borne by the company itself. Thus through franchising, the company is able to shift some of the risk away from itself onto the franchisees. The reduction of risks means that the returns will be spread amongst the franchisees, which is what will keep them motivated and hence reduce overall risks.
- The franchisor is relieved of the many day-to-day management problems of individual outlets. The franchisor now delegates authority and control to franchisees and wherever possible avoids interfering on in their daily operations. Thus staff at head office is reduced and so are staff overheads.
- The franchisor is better able to compete with larger corporations since he can reap the benefits of bulk buying for franchisees and therefore in a position to demand substantial discounts and better payment terms.
- Appointed managers cannot fulfil the crucial role to success which is determined by the highest standard of customer relationship management, which need not be monitored by the head office. A franchisee that does not look after his customers is likely to lose them and in turn the business.

## ❖ **Advantages to the franchisee**

- Access to capital

This challenge is somehow overcome as commercial banks recognize the lower risk profile of franchising and consequently prefer financing a franchisee. The banks know they have a cushion in the franchisor who has tested and fine-tuned the franchise model. Financiers like Khula and others are in a bid to assist emerging entrepreneurs are setting up equity participation funds; loans guaranteed systems, business planning assistance and general or specific business mentoring.

- Experience of the Franchisor

When buying a franchise the years of experience and proven methods of the franchisor are part of the deal. This in turn eliminates start-up problems and enables someone with little or no business management experience in a particular industry to be part thereof.

- Economies of scale

Being part of a family of suppliers of particular products/services means that buying in bulk will benefit the franchisees. The buying power is greatly enhanced and discounts, special rates and customisation are possible. Some costs are shared making expert services available a fraction of what they would cost if acquired individually.

- The franchisee sells a product or service that is already well known

Customers are familiar with the business and its image making the marketing task focussed on maintaining the quality standards set out by the franchisor.

- Training, operational manuals, accounting systems, marketing are all included in the package.

The franchisor provides initial and ongoing training. This training is aimed at preparing the franchisee in all aspects of the business. During the training skills are acquired at all levels of the

business. The training is particularly critical for emerging entrepreneurs who have little or no business management experience. The chances of the franchisee to succeed are greatly improved

- There is ongoing support, management advice, expert guidance and field/onsite service
- The franchisor is in a position to provide ongoing research and development on the products and services

#### ❖ **Disadvantages for the franchisor**

- Franchisees are not employees and therefore cannot be ordered to follow instructions. This creates a situation whereby the franchisor finds it difficult ensuring that all franchisees adhere to operating standards in order to achieve uniformity.
- The long term vision, aspirations and profit objectives may not coincide with those of the franchisor. This is likely to lead to disputes and lack of cooperation between the two parties.
- Initially the franchisee will be very content with the franchise arrangement but over time he may begin to resent the control that the franchisor has on his activities. This can lead to breakdown in communication, the relationship and may eventually result to sub-standard service in the outlet concerned.
- The franchisor has to ensure that franchisees are not under-declaring sales in order to avoid royalty payments. Thus the franchisor must develop a policing strategy to ensure that he gets what is due to him.
- The franchisor must accept that once a franchisee is fully conversant with the internal operations he may sell his franchise and open a new one in direct competition with that of the franchisor.

#### ❖ **Disadvantages for the franchisee**

- The franchisee becomes too dependent on the franchisor
- The franchisee may at times think and hope that the franchisor will help him/her in the actual running of the business and solving of managerial problems. He/she forgets that, as the

owner of the franchise, the success and its growth is to a greater extent dependent on the franchisee.

False expectations – even in a franchised business, initiative, hard work and relationship management cannot be substituted for any thing else thus they are critical.

- The franchisor keeping strict control to maintain standards of quality which some franchisor might resent. In a franchised environment it is crucial to work within a system so as to maintain consistency. A tendency may arise that the franchisee, in an attempt to reduce costs may opt for inferior inputs or less than standards of service.
- The demarcated area must have enough customers to support the business. A franchise business that has been operating profitable over more than fifteen years all of a sudden found itself having to close down because the mine, which was the main employee, was retrenching staff. There are other reasons that can cause the number of customers to decline. An increase in crime in the area, market saturation, fierce competition and reduced income are some of the causes for declining customer base.
- There is an initial and ongoing royalty fee, which a franchisee that is too independent might resent in the long run. Since the franchisee does not own the intellectual property package, he cannot get rid of the franchisor and the fees that the franchisee must pay. Regardless of the quality of service that the franchisee receives from the franchisor, the franchisee must understand that he now runs a successful business based on the franchisor's intellectual property package and hard work.

#### **2.3.1.10. Conclusion**

Important considerations have made before and during the franchise relationship.

- The franchise should be based on a successful business model
- There should be demand for the products or services
- Sites should be carefully selected
- Demographics carefully studied
- A complete support and back-up service be packaged

- Franchisee selection should not be left to chance. Thus rigorous interviews and aptitude testing is necessary
- The pricing of the franchise and any royalty fees must be carefully worked out.
- In the overall the advantages of franchising far outweigh the disadvantages.

### **2.3.2. Outsourcing**

Outsourcing is ‘an organization’s use of outside firms for providing necessary products and services’ Robinson and Decenzo (2001, 67). ‘The goal is to improve returns on assets by moving these assets off the financial books while retaining control over their use. Outsourcing is also being used to deal with top executives frustration with their information systems department’ (Sprague and Mcnurlin, 1993, 57)

Outsourcing in this study is defined as a business relationship between two companies based on one party’s withdrawal from certain activities of the value chain system and relying on the other party’s competence to provide the needed products, support services or functional activities in a way that is mutually beneficial to both. The relationship is governed by a service level agreement, detailed enough to cover key concerns but definitely not complex.

#### **2.3.2.1.Introduction**

‘Companies are increasingly outsourcing the management of information technology (IT) for reasons that include concern for cost and quality, lagging IT performance, supplier pressure, access to special technical and application skills, and other financial factors’ (Applegate et al, 1999, 369). Outsourcing is acceptable to both large and small firms as strategic alliances are now more common and the business environment, especially IT environment, is changing rapidly. Pitts and Lei (200) state ‘Alliances are especially prevalent in industries or technologies that change rapidly, such as semiconductors, airlines, automobiles, pharmaceuticals, telecommunications, consumer electronics, and financial services.’ This section identifies drivers of outsourcing; situations where outsourcing is desirable and how strategic alliances can be structured and managed.

### 2.3.2.2. What drives Outsourcing?

There is a mix of factors raising the possibility of outsourcing and these vary from company to company. Companies enter into alliances because an alliance can potentially provide benefits that are not possible either through internal development or external acquisition. Alliances can assist the firm's learning and diversification into new area of activity (Pitts and Lei, 2000). What pressures drive companies to outsource?

- **Concerns about costs and quality.** Some business activities can be performed better or more cheaply by outside specialist. Companies are always trying to find ways of conducting their business at reduced prices yet at acceptable quality standards. Companies therefore seek to tighten overhead costs associated with fringe benefit and thereby running a much leaner overhead structure, which in turn lowers increases competence and critical mass of volume. A subcontractor can aggressively use low-cost labour pools by creatively using geographical location, tighter control over inventories and other supplies
- **Poor performance.** Failure to meet service standards can force a company to find other ways of achieving stability and meeting the required performance levels. Management, who lack both time and the inclination to undertake tasks personally, find outsourcing a good choice of addressing under-performance (Applegate et al, 2000).
- **Simplified general management.** A company under intense cost or competitive pressures may 'find outsourcing a way to delegate time-consuming, messy problems so it can focus scarce management time and energy on other differentiators' (Applegate et al, 2000, 376). The subcontractor must be competent and resourceful.
- **Corporate culture.** The culture shift is unfortunately one of the hardest move which managers are faced with, as it involves relinquishing many of the 'comfort-zone' tendencies, which have evolved over many months or years (Butler, 2001). Company values can make it hard for managers to take appropriate action and outsourcing driven by senior management can provide a mechanism of overcoming such an impasse.

- **New market entry.** Outsourcing streamlines company operations in a way that improves flexibility and speedy decision-making. The shift of focus from time-consuming activities to focussing on what makes a company competitive enables the company to explore and thoroughly research other related markets for business opportunities.

### 2.3.2.3. When to outsource?

- **Position on the strategic grid.**

		Competitive Advantage	
		Low Cost	Differentiation
Competitive Scope	Broad Target	Cost Leadership <b>Outsourcing Presumptions-Yes</b>	Differentiation <b>Outsourcing Presumptions-Yes</b>
	Narrow Target	Cost Focus <b>Outsourcing Presumptions-No</b>	Differentiation Focus <b>Outsourcing Presumptions-No</b>

**Figure 2.3** Generic Strategies Grid adapted from corporate information Systems Management (Applegate et al, 2000, 380)

As shown in **Figure 2.3**, for companies in the cost leadership and differentiation quadrants, the outsourcing presumption is yes unless they are huge and efficiently managed. For companies in the cost focus and differentiating focus, the presumption is mixed, which represent an unnecessary or unacceptable delegation of competitiveness.

- **Development portfolio.** High-technology, highly structured work is a strong customer for outsourcing since the customer needs people with specialized, leading edge technical skills and/or state of the art technology (Applegate, 2000)
- **Organizational learning.** Outsourcing as part of organizational learning can be a powerful tool in terms of skill transfer and acquisition. ‘Sometimes creating or sustaining a capability involves a long, difficult learning process that is that is difficult to short-circuit at an acceptable cost’ (Thompson and Strickland, 2003, 184). Lynch (1997) talks about opportunistic strategies

that may arise as events unfold. In the case of outsourced functions, new skills previously unavailable in a company can be developed and thus moving the competences within the company to new levels. The more experience the firm has had in implementing outsourced projects, the easier outsourcing will be (Appllegate, 2000)

❖ **Areas to outsource.** A company can outsource a wide variety of functions and activities. A number of scenarios lie between a company's current situation and total outsourcing. In order to determine the extent of outsourcing, managers need to ask the following questions:

- Can the proposed function for outsourcing be easily separated from the complexities of the company
- Does the function require specialized competencies that are either difficult to acquire or time consuming to build
- Do the proposed functions or activities require special attention in the value chain?

It is important to note that the function to be outsourced must be sufficiently meaningful to the subcontractor to be able to pay sufficient attention to it. Very small functions in relations to the work that the subcontractor is performing raises concerns about their long-term viability and can cause enormous coordination cost (Applegate, 2000).

#### **2.3.2.4. Structuring the alliance**

Establishing the parameters of the outsourcing arrangement at the beginning is crucial. A well thought structure will not guarantee success of the alliance but an ill-conceived structure will make the governance process very difficult if not impossible.

- Contract and contract flexibility

Evolving technology, changing economic and political conditions necessitates those contracts longer than twelve months difficult to be written in an inflexible way. The contract should reflect a mutual interest in the relationship, a win-win situation. Further, it should emphasize the shared approaches to problem solving and exit clauses



- Standards and control

Applegate et al (2000, 384) states: 'A company must carefully develop detailed performance standards for systems response time, availability of service, responsiveness to system requests, and so on. Only with these standards in place can the company discuss the quality of support and new trends'. Sprague, Jr and Mcnurlin (1993) make an observation that outsourcing is like a marriage, so the decision is not trivial, and therefore accountability and control must be increased to the point that management does not lose control. This can be achieved through greater reliance on, and greater clarity in, service level agreements.

- Supplier stability and quality

At the time of entering into an agreement, no one knows as to how each party will perform over a five to ten year period. What is known is that the business environment will change many times and the provider of the outsourced functions must be in a position to cope with the advances in technology, retrain staff and remain financially stable. A potential conflict exists between the customer and the outsourcer in that the customer would want the outsourcer to move to new and cheap technology only to find that the outsourcer does not want to let go old and expensive technology before achieving returns on money invested. Both companies must make a profit. Managing this tensions is complex, imperfect, and very delicate and must be covered in the contract (Applegate et al, 1999)

- Management fit

In entering into an outsourcing relationship, it is important to note that the two companies have different management cultures and styles. The long-term success is determined by a shared approach to problem solving, similar values, and good personal chemistry among key role players. 'Supplier relationship can be close or distant. This will depend on the company's style and culture' (Lynch, 200, 317). It is therefore the corporate culture fit that is most important for the contract to remain in place long after the key role players have moved to other assignments.

### 2.3.2.5. Advantages of outsourcing

Using outsourcing to narrow a company's business boundaries offers significant advantages.

Thompson and Strickland (2003) have identified the following strategic advantages:

- Obtaining higher quality and/or cheaper components or services than internal sources can provide.
- Improving the company's ability to innovate by interacting and allying with 'best-in-the world suppliers who have considerable intellectual depth and innovate capabilities of their own.
- Enhancing the firm's strategic flexibility should customer needs and market conditions shift – seeking new partners with the needed capabilities already can be cheaper and less risky than re-equipping internal operations.
- Increases the company's ability to assemble diverse kinds of expertise speedily and efficiently
- Allowing the firm to concentrate its resources in performing those activities internally that it can perform better than outsiders and/or that it needs to have directly under its own strategic control

### 2.3.2.6. Risks and costs of outsourcing

- Risk of losing total control of company's own capabilities. In the event that a company outsource too many or the wrong type of activities, the company risks losing touch with the very activities and expertise that over the long run contributes and determine its success. 'Cisco guards against loss of control and protects its manufacturing expertise by designing the production methods that its contract manufacturer must use' (Thompson and Strickland, 2003, 185)
- The ever changing economic and market conditions creates the potential danger that partners may become incompatible over time as the partners find out that their long-term strategies have changed. In many cases, these possibilities are not planned for well in advance. Pitts and Lei (2000) observed that firms that once enjoyed a harmonious, close working relationship discover that the changes in their strategies or industry conditions often resulted in growing incompatibility between their goals

- ‘Alliances can often make a firm too dependent on its partner’ (Reich and Mankin, 1986, 78). The dependence can occur without the company’s awareness. Initially the outsourcing saves the company time and money. However, over time the company becomes over-reliant on their partner to do more than what was initially agreed upon and as a result the company’s skills can deteriorate while those of the partner improves.
- Working with a partner can be challenging and frustrating if the values, organizational culture and operating methods are different. Thus the cost of managing the relationship can be costly as the parties try to find one another and to keep to the spirit of their service level agreement.
- Inflexible contracts can constrain a company’s future strategy despite current benefits (Pitts and Lei, 2000). The relationship should therefore be an evolving one guided by the contract but not constrained by it, easier said than done.

#### **2.3.2.7. Managing the alliance**

Managing the alliance is the single most important aspect of outsourcing’s success. Seven identified critical areas are discussed below.

- Partnership contract management

The environment within which the outsourcing takes place is in a state of evolution. The fact that the nature of technologies, competition, political climate and the economy are continuously changing need to input to the periodic (quarterly, biannually or yearly) contract review process. In addition, both parties need to create a learning environment so as to bring their respective employees up to speed with the latest developments so they are comfortable in a climate of continuous change.

- Performance management

Realistic measurement of success is generally very hard, however a company must make an effort to develop performance standards, measure results, and then interpret them continuously (Applegate et al, 2000).

- Partnership interface

The interface between the two parties can be very complex. It is for this reason that the interface should occur at different levels. Both parties need regular, full-time relationship managers to deal with potential difficulties and operational issues.

- Balancing cooperation and competition

Outsourcing is less likely to result in a crippling effect if a company is careful in selecting its partners (Pitts and Lei, 2000). Outsourcing to partners with skills, technologies and products/services designed for the same market is a receipt for rivalry and not partnership. Thus firms with complementary technological skills make better partners since the potential for direct competition is reduced.

#### **2.3.2.8. Conclusion**

There are four activities that management should not outsource. These are the company strategy, the value chain system, the control of the service provider and the decision making process (Sprague, Jr and McNurlin, 1993). Outsourcing today is a strategic business strategy whose benefits extend beyond the original concepts of enabling managers to focus on core business and cut down on capital investments. Outsourcing remains the most cost-effective way of streamlining business processes, which enable managers to sharpen their focus on creative business opportunities, to develop or expand operations and to increase profitability.

#### **2.4. Strategy Evaluation**

During the strategy development process, strategic options available to an organization are identified. The most challenging task thereafter is to evaluate these strategies and select the most appropriate for the future. In most instances the most obvious choice is not necessarily the right one (Campbell et al, 2002). There are a number of analytical techniques that can be used. It should be understood that the purpose of evaluation is to ensure that all options are assessed with equal thoroughness.

Each option must be fairly and equally assessed through the use of a number of criteria. Johnson and Scholes (1998) suggest three evaluation criteria: suitability, feasibility and acceptability. Campbell et al (2002) add a fourth criterion – will the strategic option enable the organization to achieve competitive advantage?

#### **2.4.1. Suitability Criteria**

A strategic option is suitable if it will enable the organization to achieve its strategic objectives (Campbell et al, 2002). It is a broad assessment of whether the strategy addresses the environmental circumstances (internal and external) in which the organization is operating (Johnson and Scholes, 1998). Apart from determining the suitability of each option against the organisation's environment, it is equally important to determine how well the option delivers competitive advantage (Lynch, 1997).

In this sense the strategic options needs to be assessed in terms of the extent to which opportunities are exploited and threats avoided. Similar, they must be assessed to the extent to which they capitalize on the organization's strengths and address or remedy weaknesses. Strategies based on rational argument often find that achieving significant change to existing strategy is difficult (Johnson, 1998). Thus addressing the cultural and political context of the strategic option is equally important and critical to its successful implementation.

There are number of analytical tools that can be used to assess the suitability of strategic options. Figure 1.1, Illustrate some of the categories.

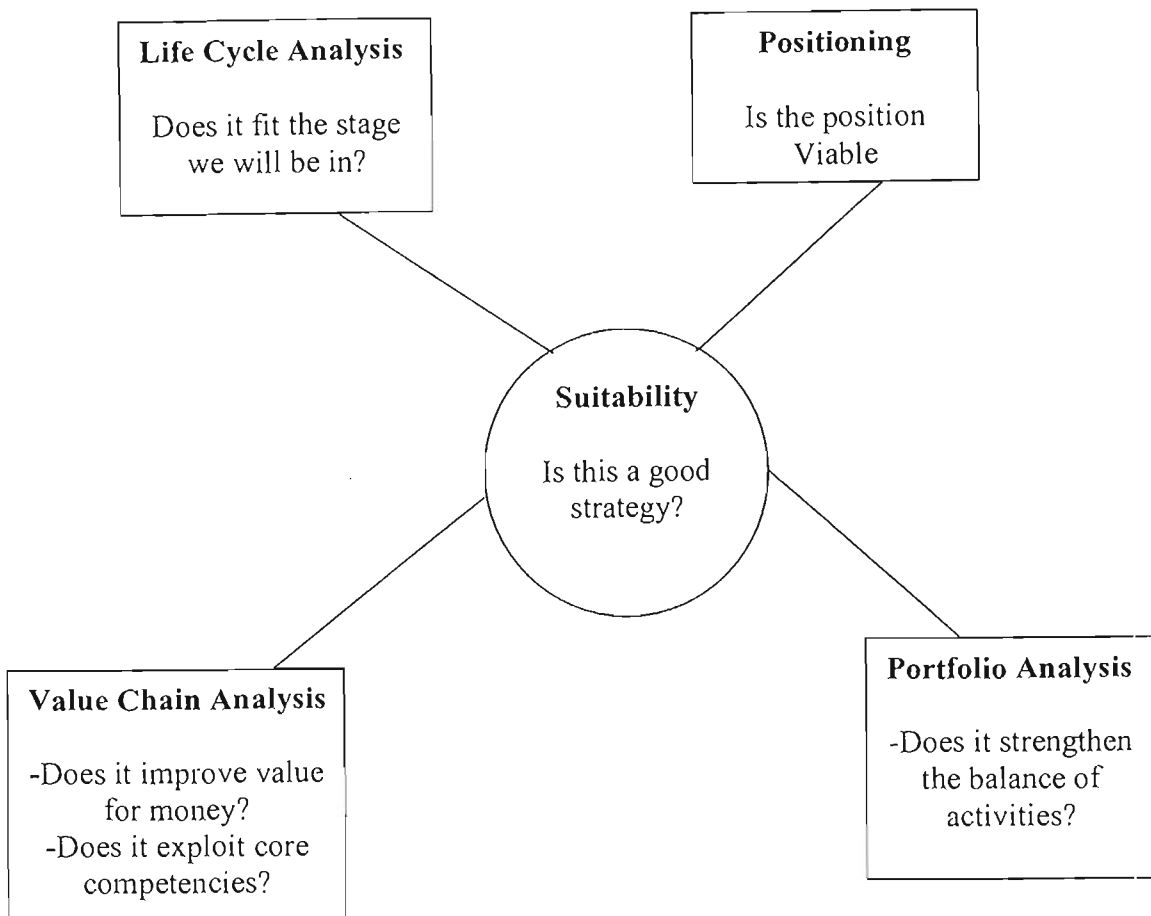


Figure 2.4. Adapted from ‘Strategic Choice’ by Johnson and Scholes (1998,356)

### ❖ Life Cycle Analysis

This approach was developed by Arthur D Little and it involves matching an organization’s own strengths or weaknesses in a market with the lifecycle phase of that market (Lynch, 1997). The lifecycle matrix consists of two dimensions:- the stage of industry maturity and competitive position. The stage of industry maturity is described in four stages ranging from embryonic to ageing and the competitive position in five categories ranging from weak to dominant.

According to Johnson and Scholes (1998), ‘the purpose of the matrix is to establish the appropriateness of a particular strategy in relation to the two dimensions. The crucial issue is to

establish where an organisation is currently positioned on the matrix and therefore what types of strategy are most likely to be suitable’.

In Table 2.3 below, the matrix illustrates some of the choices that might be made. The boxes indicate suggested strategies depending on the life cycle and share position held by the company. For an example, if a company is in *favourable* position in a *growing market*, then the strategic logic of the matrix would suggest that it:

- Differentiates itself from competition or
- Enhance its focus strategy or
- Catch up with its competitors/industry leaders
- While at the same time growing with the industry.

Hence if other strategic options for this market and competitive position were presented and did not conform to one of the above proposals, there would be a case of rejecting them. The matrix has its own flaws where major technological change and marketing initiatives are introduced. Faulkner (1997) points out another problem with the matrix when it comes to determining whether or not change will occur and in the event that it does happen, the speed at which it occurs. However it is useful in guiding strategic choice!

According to Lynch (1997), strategies in fragmented market, where it is unlikely to produce a dominant company, might include:

- Devising a ‘business formula’ that can be applied in multiple locations and restructure the industry away from fragmentation.
- Specialising in some customers and/or products
- Concentrating on low cost production: - low overheads, low wages, and tight control of all costs, and
- Focusing on a limited geographical area (Thompson and Strickland, 2003)

Maturity Stage \ Competitive Position	Embryonic	Growing	Mature	Ageing
Clear Leader	<b>Hold Position</b> Attempt to improve market penetration <i>Invest slightly faster than market dictates</i>	<b>Hold Position</b> Defend market share <i>Invest to sustain growth (and pre-empt potential competitor)</i>	<b>Hold Position</b> Grow with industry <i>Reinvest as necessary</i>	<b>Hold Position</b> <i>Reinvest as necessary</i>
Strong	<b>Attempt to improve penetration</b> <i>Invest as fast as markets dictate</i>	<b>Attempt to improve penetration</b> <i>Invest to increase growth rate (and improve position)</i>	<b>Hold Position</b> Grow with industry <i>Reinvest as necessary</i>	<b>Hold Position</b> <i>Reinvest as necessary or reinvest minimum</i>
Favourable	<b>Attempt to improve position selectively</b> Penetrate market generally or selectively Invest selectively	<b>Attempt to improve position</b> Penetrate market selectively <i>Invest selectively to improve position</i>	<b>Maintain position</b> Find a niche and attempt to protect it <i>Make minimum and/or selective investment</i>	<b>Harvest, withdraw in phases or abandon</b> <i>Reinvest minimum necessary or disinvest</i>
Defensive	<b>Attempt to improve position selectively</b> <i>Invest (very) selectively</i>	<b>Find niche and protect it</b> <i>Invest selectively</i>	<b>Find niche or withdraw in phases</b> <i>Reinvest minimum necessary or disinvest</i>	<b>Withdraw in phases or abandon</b> Disinvest or divest
Weak	<b>Improve position or withdraw</b> <i>Invest or divest</i>	<b>Turnaround or abandon</b> <i>Invest or divest</i>	<b>Turnaround or withdraw in phases</b> <i>Invest selectively or divest</i>	<b>Abandon position</b> <i>Divest</i>

Table 2.3. Life Cycle Matrix (Lynch,2007, pg 637)

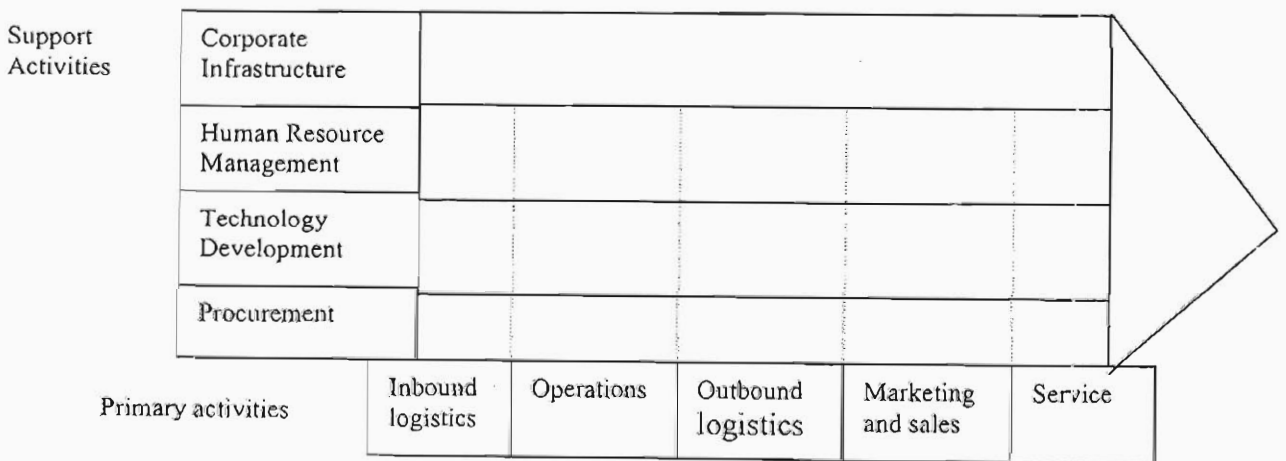


❖ **Positioning**

Another key test of suitability is positioning. This involves asking questions on whether demand of the product or service is likely to grow or decline. Once this market environment has been assessed, it becomes necessary to assess the key resources and competencies underpinning the strategy. Are these resources and competencies adding value to customers or can they be utilized such that they reduce overall company costs? Furthermore, are these resources sustainable and the competencies difficult to imitate?

❖ **Value Chain Analysis**

Value chain is 'an analytical tool that describes all activities that make up the economic performance and capabilities of the firm; used to analyse and examine activities that create value for a given firm' (Pitts and Lei, 200, 58). The value chain classifies each firm's activities into two broad categories: primary activities and secondary activities. Primary activities relate directly to the key tasks a firm performs to produce and deliver a product or service to a customer, e.g. manufacturing, distribution, sale and servicing. Support activities are those tasks that contribute or assist the functioning of primary value-adding activities, e.g. procurement, human resource management, infrastructure and technology development.



**Figure 2.5.** The Value Chain (Source: Applegate et al, Corporate information Systems Management, 1999, p72)

Figure 2.3 shows a typical value chain with its components. A strategy analysis must affect one or more of these value-adding activities, for an example improving effectiveness or fundamentally changing the activity or even changing the relationship between the activities.

The actions of one firm can significantly affect the value chain of key customers and suppliers. Thus value chains are linked within an industry or across industries to create a value system. Hence both the activities within the firm and those connecting firms with other firms and customers are potential candidates for value creation (Rayport and Jaworski, 2001).

Here is a brief description of the activities in the value chain as they may relate to a information technology service company:

- Inbound logistics may include spares and call-outs receiving
- Operations may entail technician dispatching, driving to customer premises, repairing or fixing the machine
- Outbound logistics involves parts ordering, closing of call-outs
- Marketing and sales may involve advertising, promotion and sales management
- Service involves maintaining and enhancing service value and customer relationship management
- Corporate infrastructure –all activities supporting the entire value chain such as general management, accounting and finance, legal services.
- Human resource management involves recruiting, hiring, training and development of staff
- Technology development involves improving the quality of service offered through the use of innovative and world-class technology.
- Procurement is all about purchasing inputs to all of the above activities.

A company should look at the value system in a manner that yields ideas about new business opportunities. According to Rayport and Jawaorski (2001), the firm must look for either **trapped value** to be liberated or **new-to-the-world value** that must be introduced. To unlock trapped value, companies can create more efficient value chains/systems, outsourcing non-core activities and disrupting existing pricing-power relationships to benefit customers. Companies can create new value through customized offerings, radically extend reach and access to customers, enable cooperation amongst multiple companies across locations.

### 2.4.2. Acceptability Criteria

Is concerned with the expected performance outcomes and the extent to which these would be in line with the stakeholders' expectations (Johnson and Scholes, 1998). It is important to note that the option should be acceptable to those who hold power and who have genuine interest in the organization. It is therefore important for stakeholders to focus on the expected performance outcomes such as risk or return if a strategy is implemented. If those who have power and interest in the organisation are in full support of a particular option, then that option will be acceptable even though it might not be necessarily suitable for the organization. "Some options might be more attractive to some stakeholders than others' Lynch (1997, 523). It is therefore important to ensure that the suitability assessment is thorough, rational and objective.

Assessing the acceptability of a strategy can include:

- Analysis of profits – assess financial returns of investments
- Shareholder value analysis – impact on shareholder value
- Stakeholder reactions – analysis of the political dimension of the strategy

### 2.4.3. Feasibility Criteria

If an option can be made to work in practice then the option is possible. The most determining consideration for feasibility is the resources base of an organization. Campbell (2000) states that the resource base of an organization will determine the feasibility of the option, which, in turn will determine its suitability. However, Lynch (1997) states other considerations that need to be taken into account, viz. the culture of the organization and the commitment of managers and employees.

Analytical tools to be used to assess feasibility include:

- Cash flow analysis – seeks to identify the funds that would be required for any strategy and the likely sources of the funds
- Organization culture analysis – which can be used to assess commitment from managers and employees

#### 2.4.4. Conclusion

Thompson and Strickland (2003) have distilled the lessons learned from the strategic mistakes made often by companies into 10 commandments that serve as guidelines for developing sound strategies:

- Strategy must enhance the company's competitive position in the long term
- Adapt to changing market conditions, unmet customer needs, emerging technologies and new initiatives of competitors
- Invest in creating a sustainable competitive advantage
- Avoid strategies that are capable of succeeding only in optimistic circumstances
- Do not underestimate the reactions and commitment of rivals
- Consider that attacking competitive weakness is more profitable than attacking competitive strength
- Be judicious in cutting prices without an established cost advantage
- Strive to open up very meaningful gaps in quality or service or performance features when pursuing a differential strategy
- Avoid stuck in the middle strategies that represents compromises between lower costs and greater differentiation and between broad and narrow market appeal
- Beware of aggressive moves to wrest market share away from rivals often provoke retaliation in the form of marketing arms race or price war – to the detriment of everyone's profits

096978

## CHAPTER 3

### QINOS (PTY) LTD – A CASE STUDY

#### 3.1. Company Background

In its bid for the National Lottery Licence in 1998, Uthingo Management –a consortium of a number of black companies, unions and international lottery partners- made a commitment to uplift the economy of South Africa by producing millionaires through the sales of lottery tickets. One of its social obligation clauses in its bid document was a commitment to establish twelve black owned, sustainable small companies to provide field services and maintenance of lottery equipment and other related services.

Qinos is one of the twelve (12) Regional Field Services Centres (RFSCs) that were established throughout South Africa at strategic locations. These RFSCs were to be a model for SMME development throughout South Africa.

Qinos' head quarters are in Durban. The geographic coverage is KwaZulu-Natal. The company was created directly as a result of Uthingo Management determination to use the National Lottery as a means of transformation and the creating sustainable new business for the previously disadvantaged individuals who never owned a business before. These RFSCs were to be a model for SMME development throughout South Africa. The company is owned, managed and operated by individuals from previously disadvantaged backgrounds.

#### Company Leadership and structure

Qinos is a hundred percent (100%) black owned company established in 1999 and contracted to install and maintain Uthingo's network of lottery terminals in the KwaZulu-Natal.

The long-term plan was that Qinos would use the service contract with Uthingo as a springboard to becoming a recognised BEE (Black Economic Empowerment) technology service and support provider in the KwaZulu-Natal.

Qinos Shareholders are as follows:

- **Mata Mhlungwane** is 37 years old and lives in Durban with his family. He holds a Bachelor of Science degree, a Secondary Teachers Diploma and a Post Graduate Diploma in Management. He has attended a number of short courses on IT, Project Management and Business Management over the last five years.

Prior to his appointment to Qinos, he had extensive experience with Government in Mpumalanga Province as the Chief Information System Planner responsible for all systems planning, acquisition, compliance and networks. His advice is always sought in many start-up businesses. He has over the past four years established, seven fully operational and sustainable SMMEs together with previously disadvantaged individuals who had never owned or managed a business before. He is a borne leader with all the qualities of an achiever who has a soft spot for assisting other people realized their dream.

Mr. Mhlungwane is a forty nine (49) percent shareholder and has been managing director at Qinos for the past four years.

- **NAFCOC Investment Holding Company Ltd**

Incorporated in 1994, NAFCOC Investment Holding Company Ltd was established to overcome NAFCOC's (National African Federated Chambers of Commerce) dependence on the established corporate sector and to safeguard its sustainability by utilizing the Company to generate opportunities and benefits for its membership.

Its Mission is 'To enable black economic empowerment and wealth creation for all NAFCOC members, especially at grass roots or ordinary member level, by initiating, maintaining and extending investments in shareholding in South African and other companies by providing expertise, advice, "muscle" and resources in the attainment of this objective'.

- Its investment strategy requires active involvement and a minimum 20% holding in unlisted companies.
- The CEO of this company is Michael Leaf who is a member of the Boards of both Uthingo and Qinos.

NAFCOC is a 20.5% shareholder

- **Uthingo Management (Pty) Ltd**

Uthingo Management (Pty) Ltd (Uthingo) is the first license holders for South Africa's first national lottery. Their aim is to create dreams and millionaires whilst simultaneously creating jobs in viable businesses and channelling funds via the National Lottery Distribution Trust Fund to needy causes throughout South Africa.

Uthingo Management, a black-led consortium, comprises

- 20% State shareholders (the Post Office 15% and the National Empowerment Fund 5%)
- 50% empowerment stakeholders (Black Management Forum 10%, Disability Employment Concerns Trust 10%, Motswedi Technology Group 10%, NAFCOOC Investment Holdings 10%, NUMSA Investments 5% and the Women's Development Bank Investment Holdings 5%)
- 30% international partnership (Camelot UK 10%, GTECH USA 10% and Tattersalls Australia 10%)

Uthingo Management's mission states: 'To operate the National Lottery efficiently and effectively, generate maximum sales, and provide entertainment value and the opportunity of winning to the players in a manner consistent with our core values'.

Uthingo Management is a 30.5 % shareholder. Mr. Victor Mabuza is the director representing Uthingo Management in the Board of Directors at Qinos.

- **Field Service Technicians and Administration**

The company employs eight technicians who are GTECH certified. Six of them have been with the company since inception. The other two have been with the company for less than three years. Their job description includes installing of equipment, doing preventative maintenance, attending to callouts and doing site surveys.

The administrator has been with the company for three years. Her job is to dispatch jobs received from the call centre, keep an up-to-date retailer database and performs all other office related duties like filing, bookkeeping, payroll, stock management, customer liaison, etc.

- **Outsourced Services:**

- i. Akha-Unique Telecoms provides electrical installations and maintenance services, moves and relocation service, infrastructure repairs and base stations installations.
- ii. Webcore provides computers and networks services. The company also provides field service back-up on draw days and whenever there is staff shortages or work overload.

- **Areas of Innovation:**

- i. The recently installed Geo-Tab system in Qinos's fleet of Ford Bantam bakkies facilitates use of the Global Positioning System (GPS) to track vehicle usage. This powerful tool allows management to ensure cost-effective use of the Field Technician's vehicles and maximise corrective maintenance response times.
- ii. Zoning of areas accompanied by allocation of terminals per technician ensures tight management of Field Service Technicians activities and a cost effective way of providing field services.

- **Technologies Employed:**

The Field Service Technicians must have a suitable vehicle, a laptop, a cell phone and a set of tools- ladder, screwdrivers, spanners, grey scale card and a hand held vacuum cleaner/blower. Uthingo determines these tools with the exception of the Geo-Tab GPS system

### **3.2.The Service Sector – ICT**

'Not only are we living in highly uncertain times economically and politically. We are having to adjust to the ever-shifting landscape of a high-tech world that is reshaping the very way in which we do business' (Blumberg and Devine, 2003, 1).



The greatest potential for growth in the present and future economy lies in the service sector. The cost of setting up a service business is the least compared to a product business. Some common requirements in a service business could include a telephone or cell phone, transport, an office, stationery and a computer. Income is generated in the form of charges for a service; the fee could be per hour or per volume and in the maintenance sector, per visit or a monthly/yearly flat rate. 'More and more IT companies are becoming more service orientated' (Black IT Forum, 2003, 14).

Blumberg and Devine (2003) conducted an online research to evaluate the effects of economic uncertainty on service organisations, as well as examining how organisations are solving challenges and meeting business objectives.

Slightly more than one quarter of study participants reported that their organisations are currently facing issues and/or challenges, which could be resolved with the assistance of a professional services firm. Those most commonly listed by participants included:

- development of strategies to increase revenue and/or grow customer base
- expansion into new customer market segments
- creation of new service business strategies, such as multi-vendor service, professional services or logistical services
- expansion into new technology segments
- provision of new service offerings and/or unbundling of service offerings
- deployment of new systems
- development of new pricing strategies
- market research to support development of new service offerings.

### **3.3. Monopoly cushion**

There is only one national lottery operator in South Africa. Although there are a number of gambling companies, Uthingo Management enjoys rare monopoly status, which is not in direct competition with anyone else. Casinos, horse betting, online betting and soccer betting are some of the substitutes. The real competition is within Uthingo Management. Chris Lindeque a senior manager at Uthingo Management had this to say: 'If Uthingo's marketing and customer service programmes fail to deliver an excellent service to the customers, then sales will go down. If sales

go down so will the rate that we pay for field services and maintenance. A lower rate for the RFSCs means less income and possible loss of jobs’.

### **3.4. Business Model and Strategy**

Qinos wants to

- Take advantage of the business opportunities that are presented by the favourable economic and political environment for black empowerment in South Africa.
- Remain focused in its chosen field service sector of the ICT industry, through the horizontal integration of related services.
- Cascade the benefits from empowerment projects or deals to other black start-ups or entrepreneurs thus contributing in the effort to develop sustainable black businesses

#### **❖ Service Level Agreement**

Qinos has signed a service level agreement, which commenced on the 1 April 2003 and shall continue in effect until 31 March 2007. Annual review of performance and pricing take place every last quarter of the financial year.

#### **❖ Zonal Allocation**

In 2000, the company developed a zone allocation of its resources. The province was demarcated into eight operational areas called zones. Each field service technician was allocated a zone provide technical field services. The objective was to develop cost centres so as to enable management to understand the resource requirements of each zone. As a result of this resource based management strategy, two satellite offices were opened in Pietermaritzburg and Richards Bay.

The operations of the zones were similar except for some self-management and logistics in the satellite office. The technicians at the satellite offices were entrusted with budgeting, planning and coordinating responsibilities in their zones.

Over the next three years the culture of zone operations was entrenched and became a well-oiled operational strategy that entrusted each technician with a fixed number of retailers to

service and to develop a good working relationship. Problems of technicians getting lost while trying to locate a retailer were things of the past. Travel expenditure was reduced by more than 20%.

The other positive aspect about the zone allocation is that it became obvious during performance evaluations sessions that technicians who were not putting a lot of effort during preventative maintenance sessions were getting more callout on average than good performers. Secondly, zone expenditures were all of a sudden traceable and subjected to interrogation.

### **3.5. Company Operations**

The company is responsible for:

- The field service maintenance of approximately 1400 retailers who are selling lottery tickets.
- Retail site surveys, preparation and installation of equipment.
- Corrective maintenance is done within specified parameters as set out in the current Service Level Agreement (see appendix A) with Uthingo which measures the Mean Time to Repair (MTR) and specifies penalties associated with non-performance:
  - 50km within 2 hours.
  - 50 – 200km within 4 hours.
  - 200 – 400km within 8 hours.
  - Greater than 400km within 12 hours.
- Preventative maintenance cycles as determined by Uthingo at least 3 times per annum.
- Shop-fit installation, maintenance and repairs.
- Infrastructure repairs on site e.g. antennae masts and related equipment.

#### **❖ Outsourced services**

Akha-Unique Telecoms is a black owned company that has taken the issue of empowerment a little bit further than Qinos has done. Amongst the company's shareholder are its employees and the chairperson of the board of directors is a woman. Akha-Unique Telecoms provides electrical

installations and maintenance services, moves and relocation service, infrastructure repairs and base stations installations.

Webcore is a 51% black owned company. Although it does meet the criteria of being a black economic empowerment company, it still has a long way to go before it can be in the same league as company's like Akha-Unique Telecom. Webcore provides information technology services to Qinos. The services include amongst other, the servicing and maintenance of computers and computer networks and database maintenance. The company also provides field service 'back up' on draw days and whenever there is staff shortages or work overload.

### ❖ Tools requirement

The tools requirements for the National Lottery field service maintenance can be classified into four categories:

Travel – half a ton vehicle, e.g. Nissan 1400 bakkie

Technological – at least a Pentium two laptop with functional communication ports, hyper terminal connection software and a grey scale card

Communication – a contract cell phone

Repairs – Screwdrivers, ladder, pliers, trolley and maintenance kit

### 3.6. Operational Performance

Qinos has over the past four years been up and down in terms of its performance. The performance evaluation records point out that in some months the overall company performance has been pathetic, like in July 2003, when a mere 47 preventative maintenance sites were done out of a total 350 projected for that month. In 2002, Qinos was voted the best performing company nationwide.

The explanation for the indifference performance is that the staff morale has gone down, technicians have been doing the same job over and over again and they are now bored and complacent. The company urgently requires a fresh breath of life if its is to meet its service level targets.

### **3.7. Human Resource Management**

Just like in many small businesses, coping with legislative provisions regarding human resource management is always one of the biggest challenges. The owner-manager has to ensure that the business is operational, manage the day-to-day transactions, attend to customer requests and complains, and manage his/her staff. The company has had its own share of challenges regarding human resource management.

The field service technicians are members of the Communication and Allied Workers Union. Meetings between management and the Union have not been ongoing. The meetings are organized whenever there are complains or dissatisfaction from the employees especially with regards to salary issue. In 2002, the company hired a human resource consultant to help it resolve its human resource management problems after the technicians has been uncooperative and demoralized, see appendix B.

#### **❖ Salary discrepancies**

In 1999, a human resource consultant was hired by Uthingo management to assist the RFSCs with the employment of staff. At the time, the salaries were set at different scales based on previous experience regardless its relevancy to field service and maintenance skills. As a result some of the hired technicians were teachers before joining the group and their salaries were set very high (R 6 800) compared to the new graduates from technikon (R4 500), a difference of R2 300!. Management has, for the last two years, worked hard in trying to close the gap between high and low earners. In 2003, the highest paid technician was getting R7 200 and the lowest paid with the same experience getting R6 000, a difference of R1 100!

Again, the company hired a consultant to do a market research on the market related salaries for field service technicians in the ICT industry, see appendix C.

#### **❖ Culture**

The company has advocated a strong culture of responsibility, self-discipline and management, a culture of learning and development, teamwork and co-operation, and performance management and rewards.

## ❖ Discipline

Disciplinary steps or corrective measures taken against technicians who lose or damage company equipment or tools, have not been consistent. In many instances the company was willing to replace lost or stolen equipment without a thorough investigation as this was seen as a waste of time by the manager, even though at one stage a technician's employment was terminated when it was established that he had lied about the loss of a company cell phone, which he had given to his girlfriend as a present. The company is currently looking at paying the technicians a tool allowance, a flat rate for the use of a cell phone which, shall be owned by the technician, a laptop allowance and indeed, a car allowance.

## 3.8. Financial Performance

The company charges a flat rate of R131 per terminal that it services and maintains on a monthly basis regardless of whether the equipment failed or not. There is therefore a predetermined monthly income rate based on the 1400 terminals under Qinos jurisdiction.

The other income comes from installations, de-installations and outsourced activities. Installations and de-installations are charged at R150 per hour and R1.25 per kilometre. Income from outsourced activities is based on ten percent (10%) commission of the total income due to the subcontracting company.

The company is currently repaying a start-up loan of R850 000 from Uthingo on a monthly instalments fee of R50 000. It is expected that the loan will be fully paid by the end of July 2004.

The company is profitable. See appendix D for income statement, appendix E for the balance sheet and appendix F for the annual budget.

## ❖ Growth Potential

The company currently has one and one customer, Uthingo Management. It is so dependent to Uthingo Management such that it has very little bargaining power and no other source of income. Qinos management is currently faced with a number of challenges that must be resolved soon:

- development of strategies to increase revenue and/or grow customer base

- expansion into new customer market segments
- creation of new service business strategies, such as multi-vendor service, professional services or logistical services
- development of new pricing strategies
- The management has identified a number of related services in the ICT industry that the company is yet to explore. These include DSTV installation and maintenance, telecommunication network equipment maintenance, personal computer swap-outs, fax machine swap-outs, printer swap-outs, electronic cash registers swap-outs, and other technology products and/or services.

### **3.9.Strategy Review**

In the meeting of the board of directors held on the 31 July 2003, the managing director raised the following strategic issues that the company must embark on in the 2004/2005 financial years:

- Seize some of the business opportunities that are presented by the favourable economic and political environment, grow the business through horizontal integration of related services
- Provide a world-class service in the ICT field service and maintenance sector of industry
- Cascade the benefits from empowerment projects or deals to other black start-ups or entrepreneurs thus reducing capital outlay for Qinos and at the same time contribute towards the development of responsible and sustainable black businesses towards the development of responsible and sustainable black businesses

The main threat Qinos currently face is the loss of business or income due to the company's dependency on one customer. As a result if any of the following events occur, then Qinos will be out of business: the expiry of the lottery agreement in three years time; the daily risks of Uthingo Management breaching its license agreement leading to the termination of the contract; declining lottery sales in KZN leading to reduction of service fees or rezoning of geographic coverage or both.

The strengths of the company lies in the fact that it enjoys monopoly in the servicing of lottery equipment and therefore can afford to experiment with new ideas within the lottery set-up or externally without any fear of loosing out completely. The geographic coverage is the most

extensive for a single black owned company amongst all twelve RFSCs, covering some 1400 retailers spread across the province including the most rural magisterial districts. The leadership of the company has a vision for the future and superior management skills. A very strong culture of hard working, taking responsible for one's action and being rewarded according to effort put, has contributed tremendously towards the company's success thus far. The current staff complement is competent and experienced.

Some weaknesses are clearly observable in the human resource management activities of the company. Workers are the most important assets that the company has in its quest to provide a world-class service and make profits. The fact that some issues like the salary discrepancies have not been resolved after four years is a serious flaw from the company's management. Vehicles continue to be damaged, tools and laptops lost or damaged and there is no consistent management approach of holding staff accountable.

### **3.10. Conclusion**

Qinos is in a perfect situation to consider business growth strategies. The company is effectively run and managed. The company has sufficient capacity and resources to develop, implement and sustain a unique growth strategy.



## CHAPTER 4

### STRATEGY EVALUATION

#### 4.1. Introduction

During the strategy development process, strategic options available to Qinos as an organization were identified. Qinos has identified that either franchising or outsourcing would be the appropriate strategic option to implement if the following objectives are to be met:

- Seize some of the business opportunities that are presented by the favourable economic and political environment, grow the business through horizontal integration of related services
- Provide a world-class service in the ICT field service and maintenance sector of industry
- Cascade the benefits from empowerment projects or deals to other black start-ups or entrepreneurs thus reducing capital outlay for Qinos and at the same time contribute towards the development of responsible and sustainable black businesses

Without being too simplistic, the objectives seems to seek a flexible organizational structure that will be in a position to provide field service to multiple vendors thereby establish new market segments and/or technology segments while at the same time contributing to entrepreneur development.

#### 4.2. The business environment

Empirical studies confirm the fact that the greatest potential for growth in the present and future economy lies in the service sector where the cost of setting up a service business is least compared to a product manufacturing business.

Many companies are outsourcing their non-core activities. The outsourcing of field maintenance services is high on the agenda for many vendors who believe that through outsourcing they can cut on their overhead costs and achieve a better service delivery from a company whose focus is field service maintenance and therefore understands better all the issues associated with running such a company profitable.

Many customers have more than one vendor specific electronic equipment. A service provider who has the necessary competencies to repair and maintain more than one vendor-equipment

stands a better chance to capture new market segments. New market segments within the same geographical area will not influence the running costs negatively since some of the service calls can be serviced on route to others.

A company with a flexible organizational structure is in a better position to take advantage of new technology segments and therefore able to provide new service offerings at competitive prices.

The resources and skills required are not difficult to get and therefore the entering into exclusive strategic agreements with vendors lasting for more than three years, guarantees sustainability and growth. During the period of engagement, technology may change and therefore retraining of personnel must be undertaken. It is therefore important that the agreement with the vendor takes this into account.

Politically, there is legislation in the pipeline on black economic empowerment. Many industries are currently involved in discussions on the programme of black economic empowerment as it applies to their industry. Field service and maintenance activities cut across many of the industries, as each industry is dependent on information and communication technology for its successful operation. In particular, the Information and Communication Technology Charter will seek to address the imbalances of the past where major players in this industry have been white males. Qinos stands to benefit from empowerment programmes of some of the companies. The financial sector presents attractive opportunities for small companies involved in information and communication technology service and maintenance.

The fact that Qinos currently has one contract to provide field services, exclusively, to Uthingo creates a danger for the company in the event that Uthingo or one of its suppliers violates the provisions of the Lottery Act and Uthingo is forced out of business. Alternatively, if Uthingo is unsuccessful to secure a second term to run the national lottery, then Qinos will be out of business too. It is therefore important that Qinos starts preparing itself to be an independent service provider to a broad spectrum of companies who require its services.

### **4.3. Internal environment**

The company is hundred percent black-owned by people with a vision and an ambition to grow and sustain the business. The directors have corporate experience gained from doing similar functions in other well-established companies.

The company has a sound business background having successfully run the company since September 1999. In that year, the company employed and trained eight technicians who went on and successfully installed more than 1200 lottery terminal across the province.

Over the past four years, the company has grown from strength to strength. Firstly it was the signing of the service level agreement with Uthingo to provide field maintenance services for seven years. Secondly, it was the successful negotiation with Uthingo to hand over electrical installations, which Qinos has now successfully outsourced, to Akha-Unique Telecoms. Thirdly, the successful negotiation of the transfer of the shop fit function to Qinos during the 2004/2005 financial year.

The company has accumulated a lot of experience in contract negotiations, pricing strategies, business management and customer relationship management.

The company has weaknesses in as far as human resource management is concerned. The current managing director is a strategists of good standing however, he seems to struggle a lot with managing people as it can be seen from the human resource reports compiled by Chiliza in appendix A. The issue of salary discrepancies is still unresolved despite the recommendations by Renwick Reward in appendix C.

The current organizational structure requires that the managing director be responsible for almost everything from operations management, human resource management, financial management, etc. The managing director is thus paying attention to day-to-day activities giving him no time to pursue other business opportunities. Such a business structure is not flexible so as to allow for business growth. What the company needs now, is to free the managing director of his day-to-day activities so that he can concentrate on business opportunities and managing existing contracts.

#### 4.4. The ideal strategy

The most appropriate strategy for Qinos is the one that will change the company's rigid structure to a flexible one, which can accommodate changing business environment and internal competencies. The strategy must at the same position the company as an accredited multi-vendor field service provider in KwaZulu-Natal with an intention expanding nationally over the next three to five years. Lastly, the strategy must ensure that a social programme to develop entrepreneurs is successfully implemented.

The company is trying to achieve a lot more all at the same time. This is not to say that all of the above cannot be achieved. However, it needs to be mentioned that for the strategy to be successfully implemented, a lot of commitment and effort from all concerned must be displayed.

#### 4.5. Suitability Criteria

##### ❖ Life Cycle Analysis

In Table 1.1 below, the matrix illustrates some of the choices that might be made based on the company's competitive position and the stage of the industry's maturity. The ICT service industry is the fastest growing industry in the world and this includes South Africa in general and KwaZulu-Natal in particular. The company has been in operation since 1999 and over the years has established itself as one of most promising black-owned field service company in an industry dominated by white-owned companies. Qinos is therefore, both in a *favourable* position in a *growing market*, and hence the strategic logic of the matrix suggests that it:

- Differentiates itself from competition or
- Enhance its focus strategy or
- Catch up with its competitors/industry leaders
- While at the same time growing with the industry.

However, since the ICT field service market is fragmented, Qinos strategies might include:

- Devising a 'business formula' that can be applied in multiple locations and restructure the industry away from fragmentation.
- Specialising in some customers and/or products

- Concentrating on low cost production: - low overheads, low wages, and tight control of all costs, and
- Focusing on a limited geographical area

Maturity Stage \ Competitive Position	Embryonic	Growing	Mature	Ageing
Clear Leader	<b>Hold Position</b> Attempt to improve market penetration <i>Invest slightly faster than market dictates</i>	<b>Hold Position</b> Defend market share <i>Invest to sustain growth (and pre-empt potential competitor)</i>	<b>Hold Position</b> Grow with industry <i>Reinvest as necessary</i>	<b>Hold Position</b> <i>Reinvest as necessary</i>
Strong	Attempt to improve penetration <i>Invest as fast as markets dictate</i>	Attempt to improve penetration <i>Invest to increase growth rate (and improve position)</i>	<b>Hold Position</b> Grow with industry <i>Reinvest as necessary</i>	<b>Hold Position</b> <i>Reinvest as necessary or reinvest minimum</i>
Favourable	Attempt to improve position selectively Penetrate market generally or selectively <i>Invest selectively</i>	<b>Attempt to improve position</b> <b>Penetrate market selectively</b> <b>Invest selectively to improve position</b>	<b>Maintain position</b> Find a niche and attempt to protect it <i>Make minimum and/or selective investment</i>	<b>Harvest, withdraw in phases or abandon</b> <i>Reinvest minimum necessary or disinvest</i>

**Table 4.1.** Life cycle matrix

Franchising is suitable in differentiation itself from competitors, specialising in some products or customers and focusing on limited geographical area. However, for the franchise to expand in many locations, franchisees are required. Before the franchisees can be secured, they must exist together with the required down payment. The period between the identification of a potential business growth location and the actual set-up of the franchise, can be excessively long leading to other competitors making the first move.

The other negative consideration with franchising is that the market might be growing but poor service in another franchisee may lead to bad publicity to such extent that the franchise network collapses in the face of economic growth.

Outsourcing on the other hand provides Qinos with a number of options. Through the use of contractors, Qinos is in a position to penetrate the market through the use of existing contractors in information gathering, vendor contracting or assuming full responsibility for developing new market segments or product segments. Qinos is in a position to lower its operational costs through the use of contractors yet at the same time differentiate itself from competition through guaranteed turnaround time, service quality and value added. Thus outsourcing is more suitable when implemented by a company whose competitiveness is favourable and operating in a growing market.

### ❖ Positioning

The environmental factors indicate that the demand for field service in the ICT sector is growing. The company does have key resources and competencies to take advantage of these opportunities.

Franchising is in many instances limited to one product or service. In the ICT sector technology advances are daily developments. The skills of a franchisee, in most instances, should be easy to acquire/transfer. The franchise must be protected in terms of trademarks and patents. The franchise must have a proven formula that has been successful for at least twelve months before franchising. The franchise must be registered with the Franchise Association of South Africa for it to be recognized as a genuine business franchise.

Qinos can secure any field service and maintenance contract from any vendor and be in a position to seek and acquire the necessary skills and expertise through outsourcing. The skills are there and can be hired at short notices and be utilized for the duration of that particular contract. There are no training costs and no waiting period for the relevant skill to apply. The relationship is project based and is automatically terminated at the end of the period of the contract. No strings attached. Outsourcing seeks to utilize the company resources and competencies in order to add value to customers yet at the same time reduce overall company costs. The strength of Qinos should therefore be in building strong relationships and networks amongst major players in the ICT industry so that it is the company of choice when field service and maintenance is to be outsourced. The company has the necessary resources and the competencies to managed more than one contract.

## ❖ Value Chain Analysis

The activities in the value chain as they may relate to the existing field service and maintenance activities are:

- Inbound logistics: the ordering and receiving of spares required in repairing the lottery equipment, the receiving of callouts for repairs and feedback from Uthingo on performance on a daily basis.
- Operations: the dispatching of technicians to attend to a callout, driving to customer premises, repairing or fixing the machine within the provisions of the service legal agreement.
- Outbound logistics: once repairs are done, the callout must be logoff with Uthingo's call centre and a reference number is then issued; paper work is received and spares are ordered
- Service involves maintaining and enhancing service value and customer relationship management
- Corporate infrastructure –all activities supporting the entire value chain such as general management, accounting and finance, legal services are already in place..
- Human resource management involves recruiting, hiring, training and development of staff. Qinos is very weak in the management of human resources but very strong in contract management.
- Procurement policies and procedures are already in place.

Franchising retains marketing and sales, technology development and at times procurement. The operations are standardized with every franchisee expected to follow the same standards regardless of what local customers might prefer. In instances where the franchisor handles the procurement aspects of the business, the franchisee's role is reduced to that of store operations depriving him the opportunity of making choices about the quality of supplies and their prices. In the event that the franchise collapses, the franchisee may not be in a position to take an initiative and set up a similar business because of the over dependency on the franchisor.

Outsourcing offloads operations and retains all the other activities. Qinos will continue to dictate how, where and when are the operations to be carried out. A company that has the required competencies performs these operations thus freeing Qinos management of the details

As a result, Qinos can look at the value system with a lens that yields ideas about new business possibilities, specifically Qinos can look for a strategy that either unlocks trapped value or introduce new services or does both.

To unlock trapped value

- Qinos can create more efficient value chains/systems through outsourcing non-core activities.
- Qinos can disrupt existing pricing-power relationships to benefit customers, which is easily achieved through outsourcing and not so easy through franchising.

Qinos can create new value through:

- customized offerings and radically extend reach and access to customers which, outsourcing is able to attain.
- enabling cooperation amongst multiple companies across locations which is easy to achieve through outsourcing.

#### **4.6. Acceptability Criteria**

Qinos stakeholders expect the company to be profitable and sustainable in the long run. Analysis of profits based on the franchise model involves projection of income from the sale of all six zones as franchisee and the monthly income from royalties, less the expenses of marketing, field support and head office expenses. A franchise consultant who does not come cheap must develop a franchise business plan. The flexibility of the company is severely constrained by a franchising strategy. The success or failure of the franchise depends to a larger extent on the franchisor.

Relationship management in franchises is the key to a successful franchise network where each individual must understand that the franchise will succeed if all franchisees maintain the same standards.

Outsourcing guarantees an immediate reduction of overhead costs, an improved service to the customer, a number of options to withstand changing market conditions and steady monthly income from its core activities. The relationship between Qinos and contractors is detailed in the service level agreement. A customer/supplier relationship is established and there is no dependency on the customer to look after the interest of the supplier. The supplier either provides



the services at least according to the provisions of the service level agreement or the contract is terminated if after warnings there is still no improvement.

The obvious shortcoming of outsourcing is the mentoring of emerging black entrepreneurs who might or might not have the technical skills required in this field. This shortcoming needs to be adequately addressed in order to ensure that the company's objective on developing black entrepreneurs is achieved.

There are a number of outsourcing agreements that can be used as a point of reference when outsourcing. Uthingo's service level agreement with Qinos can be rewritten by changing a few clauses and made suitable for the Qinos outsourcing strategy.

The cash flow projections in Appendix G show Qinos new financial position with a guaranteed monthly income of R25 000 and the subcontractors combine monthly profit of R12 000. Management is freed from day to day management of operations and focuses on business growth opportunities.

The company is a learning organization, which values responsible provision of services and employee development. The zonal operations have developed a culture of customer relationship that never existed before. The provisions of the service level agreement are discussed every time there is a staff meeting to such an extent that every staff member now has a clear understanding of what is expected out of him or her. There is a strong, natural and African based way of respect, loyalty and friendship within the organization. All these factors are a central requirement for a successful outsourcing function.

#### **4.7. Essential differences**

The relationship between a franchisor and a franchisee is that of a big brother who has to provide almost everything to the small brother who does not have the know-how of running a business but has the funds to start a business. Dependency on big brother can develop to propositions, which are unmanageable. Multi-franchising is a difficult proposition but attainable. Thus franchising is suitable for low-end activities in the ICT chain like parts distribution.

The relationship in outsourced projects is that of a customer/supplier and the customer relationship in favour of Qinos applies. The supplier is expected to perform according to the service level agreement and there are no ambiguities about what is and what is not expected of him. Qinos can sign many vendor-specific contracts and be able to execute them all with the use of skilled subcontractors or internal competencies.

#### **4.8. Conclusion**

Franchising requires that patents and trademarks should be legally protected for it to be sustainable. The franchisor is responsible for the business for the re-engineering of the entire business network. Franchising is capable of succeeding most in optimistic circumstances.

Through outsourcing Qinos can adapt to changing market conditions, unmet customer needs, emerging technologies and new initiatives of competitors. Furthermore, Qinos will always be ready to adjust to market conditions without losing its strategic trust. Outsourcing can put a company in a position where it can cut prices based on an established cost advantage. Outsourcing seeks to create a sustainable competitive advantage in the long term.

Outsourcing satisfies most of these criteria. However, there is one shortcoming that needs special attention for outsourcing as a strategic option to be able to address Qinos' strategic objective of developing black entrepreneurs. In the next chapter we recommend a strategy that addresses all the concerns discussed in this chapter and consolidates the strengths of both options.

## CHAPTER 5

### THE HYBRID STRATEGY

#### 5.1. Introduction

In the previous chapter we concluded by saying that neither of the two options is, on its own right, suitable for Qinos strategic objectives. Outsourcing has all the elements that Qinos is looking for except the social responsibility objective of entrepreneur development, which is not met. This therefore indicates that the main reason why franchising was considered in the first place, is the fact that it has strong business mentoring aspects embedded within its development process.

The concern that Qinos' decision makers is that of implementation of the outsourcing strategy under self-imposed responsibility of empowering the previously disadvantaged individuals while at the same time not losing focus on the main business objectives of running a profitable and sustainable business. It is important that the directors at Qinos come to an agreement about the above assumption, as it will form the basis of the proposed implementation plan.

This chapter presents a view that outsourcing is the best option available to Qinos under the existing market conditions. The only condition that the strategy must satisfy during implementation is that of empowerment. Qinos must therefore develop a customized version of outsourcing to address the above-mentioned condition. An implementation plan is also presented.

#### 5.2. Hybrid strategies

The combination of the positive features from two or more strategic options yields a hybrid strategy tailor made for that company's unique situation and requirements. Bissek (1997, in Johnson, 1999) illustrates this point by citing the activities of a multinational company whose 'subcontractors became franchisees, responsible for laying cables'. In this situation, the multinational company initially outsourced its cable laying activities and later on decided that the subcontractors must become franchisees.

In the case of Liberty Group's franchise, the uniqueness of their opportunity is demonstrated in the support offered by the Group and from the fact that there is no up-front fee, royalties or hidden costs. Montgomery (2000), the Group's academy, says: 'Our franchisees are provided with the necessary infrastructure and training to start their businesses free of charge'. This is a business that requires self-starters, achievers and hard workers. The performance and therefore income is measured by the number of customers who have signed up for policies.

### **5.3. Qinos hybrid strategy**

The strategic option recommended is outsourcing with very strong mentoring programme embedded within it in order to facilitate economic empowerment. The difference with normal outsourcing is the conscious decision making not to outsource to anyone who presents his skills Qinos but to a designated, previously disadvantaged group of individuals who can provide world-class field maintenance services. The main trust of outsourcing is the flexibility of organizational structure suitable for both favourable and unfavourable economic and business climate. It presents the company with such flexibility that Qinos can be in a position to pursue business growth opportunities with little concern about the day-to-day detailed management of the lottery business and indeed future field service opportunities.

### **5.4. Strategy motivation**

The basis of this recommendation lies in the fact that:

1. service providers are becoming a more integrated, strategic part of the business so that they are better able to customize business solutions to enhance the current and future development of operations.
2. clients do not want to deal with a number of different service providers for each of their field services, they need a 'one-stop' service provider with expertise in all areas in the field service industry.
3. the industry is highly innovative and require constant upgrading of skills and retraining.

4. the skills required are vendor specific and would require personnel to be trained by the vendor to whom Qinos is contracted.
5. Qinos does not have patent or trademark rights to the products. The company only provide field service and maintenance activities according to the specifications of the vendor.
6. the strategy allows for minimum upfront investment in the form of tools and vehicles.
7. the essence of the strategy is outsourcing, for which the company has experience of managing, coupled with the mentoring and support activities of franchising.
8. the subcontractors are independent from the company and the relationship is that of a supplier and a customer governed by a service level agreement which in many instances will be shorter version of Qinos service level agreement to the vendor.

## **5.5. Strategy implementation**

### **Qinos Network of Subcontractors**

Six (6) Qinos Support Centres (QSCs) will be established through out KwaZulu-Natal at strategic locations and will be a model for SMME development throughout South Africa. They shall be created directly as a result of Qinos determination to use the Uthingo's contract as a means of cascading empowerment and transformation, creating sustainable new business to be owned, managed and operated by individuals from previously disadvantaged backgrounds.

The purpose of this business plan is to give direction and guidance to the stakeholders at Qinos for the successful implementation of their goals.

### **The Development of the QSCs**

The owner-operators of the QSCs will be recruited from the area in which they will operate. Qinos will employ mentoring, field and administrative staff. The QSCs companies will provide lottery retail terminal maintenance services under contract to Qinos over the term of the contract

with Uthingo, which is expected to be years. The QSCs will provide these critical services provincially, through the direct efforts of the owner-operators who are from previously disadvantaged backgrounds.

### **Financial Strength**

The six QSC will be financed through a mixture of equity, shareholder loans (quasi-equity) and external bank debt. It is anticipated that the shareholder loans and the bank debt will be repaid on average within one year.

The value of contract with Qinos for the Qinos Support Centres (QSC) is approximately R160 000 per month over the next year (Approximately R5 760 000). The QSC should achieve an average return on share capital employed of 15%.

### **Sustainability**

The contract with Qinos will in itself provide full sustainability for the contract period. However the six QSC will in addition be well placed to assume and develop further new business opportunities as a direct result of the expertise and mentorship that will be provided during the first two years servicing the Qinos contract. The six QSC will in the long-term have the specialist infrastructure and trained personnel in place to perform similar services to other companies in KwaZulu-Natal at very competitive prices.

These additional contracts will ensure that the QSC are sustainable beyond the first National Lottery Licence term and well into the distant future.

### **Job Creation and Skills Transfer**

The six QSC will employ permanent staff of some 16 Field Technicians (which include six owner-operators). Qinos will employ an administrator, a field service supervisor, and compliance officer; all from disadvantaged backgrounds. Qinos with GTECH and WBS (together with other suppliers) will provide initial and ongoing training in product assembly, bench technician and general IT skills during the course of employment. The initial number of employees for the each QSC will be two (2).

Qinos will provide mentoring and training regarding technical services. In addition, GTECH will provide annual training and technical audits. This will ensure that the latest developments in the industry are introduced to the QSC and ensure that each QSC is recognised as a Zonal Field Service centre for excellence in its principal technology, the installation, preventative maintenance and ongoing maintenance of electronic devices.

C J Wilkinson will provide accounting services and financial management and corporate governance mentoring.

C Makhubela & Associates will provide legal counselling and related services.

### **Wealth Creation**

The six QSC total revenues over the contract period will exceed R5,7 million, generating average annual operating profits – before taxation – of approximately R15 000 to R20,000 per QSC from the contract with Qinos alone. This will put the six QSC's revenue per employee at an average of R120 000 per annum (5.7millions / 16 employees / 3years).

### **Social Responsibility**

The QSC will be selected from the region/zone in which they operate. This will ensure that they operate from within the community and contribute to the community through the employment of local people. It is expected that they will contribute to the community through local action groups. The mission of the six QSCs is to provide high quality and responsive field maintenance services to Qinos on behalf of Uthingo and, within two to three years, to other customers.

Qinos will ensure that these owner-operated entities are competitively paid for their services and that they receive continuous technical training and development. This skills transfer programme will ensure that employees of the six QSCs are among the most technically competent members of the previously disadvantaged anywhere in South Africa.

The contract with Qinos, on behalf of Uthingo, for the provision of regional installation and field maintenance services will provide the base for the development of a sustainable business. The

QSCs through its mentor, Qinos, will develop the skills of owner-managers in business management, technology and business development.

It is each QSCs short-term strategy to learn, develop and improve upon operational processes and skills attained from the Qinos contract and ongoing mentoring. In the long-term, Qinos, together with the six QSCs, will develop the business to provide similar services to other companies, reducing its dependence on the contract with Uthingo.

## **5.6. Legal Structure, Ownership and Financial Structure**

### **Legal Structure**

Each QSC is incorporated as a close cooperation under the Companies Act. The ordinary shares will be allotted from those issued under the Articles of Association. Each ordinary share will carry equal voting rights.

### **Ownership**

Qinos will determine the ownership of the QSCs through a selection process and Qinos shall own not more than 50% of the allotted shares. The owner-operators of the QSCs will be selected from the current employees and the local community. It is anticipated that at a minimum the operator will own the QSCs. However, there is room for some of the employees or Qinos' strategic partners to become co-owners of the support services.

### **Financial Structure**

The financial structure of the QSC will be in the form of cash equity, shareholders' loans and third party debt.

Cash Equity: The shareholders will secure financing through a special purpose vehicle such as Umsobomvu Youth Fund or Sizanani Financial Services, to provide cash equity.



Shareholders' Loans: Shareholders Loans; which will carry a premium of 400 basis points above the running –month bank access (BA) rate, will be subordinated in favour of external debt and creditors.

External Debt: Each QSC will secure external term debt from local financing institutions such as Khula Finance Scheme

It is anticipated that Qinos market share will grow during the next two to three years such that additional financing for expansion purpose will be necessary. Unless the cost of external financing has reduced significantly by that time, the QSC might find such expansion difficult. It is therefore critical those expansion projects are undertaken once the debt has been reduced significantly and the overall risk is minimal.

The financing for the different SMMEs will differ due to the size and thus the required initial investment. It is anticipated that the shareholders loans and bank debt will be repaid within one year of operation. Dividends will only be declared once the shareholders debt and bank has been reduced significantly.

## **Revenues**

The QSCs will experience no barrier to entry into the lottery market. Qinos will establish the QSCs specifically to respond to the opportunity of providing field maintenance services for Uthingo under its direct control and guidance. The cost of this service to Uthingo has been benchmarked against the identical service for the identical on-line terminal (GTECH's Isys) nationwide.

The job evaluation research conducted by Renwick Reward shall form the basis for determining the remuneration of owner-operators. Any variations shall be as a result of cutting out inefficiencies and the provision of quality service on a 'doing it right the first time' basis. Qinos has already provided training and will continue to provide support and mentoring services at a charge, which shall be reasonable set, as it will take into account the volume of transactions and the number of personnel from the QSCs involved.

The revenue stream for each size of QSC is therefore provided with an unusually high degree of certainty as it is Uthingo’s policy to see to it that Qinos runs a sustainable business and this positive gesture shall cascade to each QSC.

In addition, the charge per terminal per month depends on the number of terminals the QSC supports. This is due to the increased efficiencies that can be extracted by the small QSCs when compared the to large QSCs.

## 5.7. Management and Personnel

### Management

The management of operations in each of the six QSCs will be vested in the owner-operator. The owner-operator will be selected from within the current employees or the local community. Qinos and C J Wilkinson will provide mentoring and monitoring of the SMMEs. This will include the following:

#### Qinos

Provide Business Infrastructure  
Assist with staff selection  
Technical development and training  
Technical Reporting, Control and Procedures  
Technical support  
Problem/Call dispatch services

#### CJ Wilkinson

Assist with establishing of the QSC  
Business development training  
Financial Reporting and Controls  
Legal establishment and advice

The owner-operator will be provided with the business and technical skills necessary to run all QSC business activities (mentored and monitored by Qinos and CJ Wilkinson) and terminal field installation and maintenance activities.

The number of operational and support staff shall be based upon the total number of terminals in use at any one time and the anticipated margins for these units. The six QSC staffing level is based on anticipated an initial total terminal population of approximately 1300 terminals and the historical versus actual margins data observed in other jurisdictions. Since the QSCs are an

extension of the current Uthingo regional allocation of terminals and pricing strategy, it shall be expected that any changes that Uthingo wants to effect on Qinos will have a cascading effect on the QSCs.

<b>Area</b>	<b>Number of Staff</b>	<b>Serving</b>
Midlands - Pietermaritzburg	2 X Technical	Pmb, Ladysmith, Escourt, Greytown, Pinetown, Queensburg, Westville,
South Coast - Portshepstone	2 X Technical	Richmond, Ixopo, Underberg, Pshepstone, Port Edward and Surrounding Areas
North Coast – Richards Bay	2 X Technical	Richards Bay, Pongola, ryheid, Ulundi, Melmoth and Surrounding Areas,
Dolphin Coast - Stanger	2 X Technical	Eshowe, Gingindlovu, Stanger, Ballito, Phoenix, Inanda, Kwa Mashu, Newlands, Tongaat, Surrounding Areas
Durban North - Durban	2 X Technical	Durban Central, Morningside, Berea, Umhlanga, Durban North
Durban South - Durban	2 X Technical	Chesterville, Bluff, Umlazi, Isipingo, Prospecton, Toti, and Surrounding Areas

**Table 5.1.** Qinos’ six service centres

The lottery terminals population growth has reached a maturity stage. Thus the increase in number of employees beyond year 2 and year 3 will depend largely on the ability of the Qinos in conjunction with the QSCs to develop additional business opportunities.

Based on current black economic empowerment drive, especially the Information and Communications Technology Charter, it is anticipated that the number of employees per SMME will grow by one person every time a regional contract is signed with a major client. Zonal business initiatives shall be undertaken in those areas where the specialized services are required.

For an example, a client might want services to be provided in Durban, Pitermaritzburg and Richards Bay only. On the other hand, a government/community development organization might require services to be provided in the rural areas. Thus the number of employees in the table above does not include the additional employees required to support additional contracts. Such requirement shall be determined on merit.

The company will operate within the guidelines established under the Employment Equity Act. Applications for employment and ongoing opportunities will be treaded in a uniform manner regardless of the candidate employee's gender, ethnic origin, religion or geographic, linguistic or cultural background. However applications from persons previously disadvantage and disabled will be given due consideration to ensure that such factors are taken into account for their benefit in the selection process.

In addition, each employee will be trained in basic health and safety awareness and will be made aware of the provisions of the company's health and safety policy.

### **Training and Capacity Building**

Qinos and CJ Wilkinson will support each QSC in terms of both training and capacity building. Both of these companies have a vested interest insuring that each QSC is empowered so that it can take genuine advantage of the opportunities, which face it as a resulting of its connection with Qinos and the National Lottery.

Scheduled mentoring and performance management sessions shall be held every month. Field service support and reporting shall be done on a daily basis.

### **Technical Training**

Technical training will be provided in consultation with GTECH according to plans formulated by Qinos in the following areas:

- Inventory management, control and storage
- Terminal and radio installation

- GVT installation,
- Preventative maintenance and ongoing maintenance procedures;
- De-installations
- Call dispatch and follow-up
- Customer relationship management
- Quality Control, including general house keeping rules
- Weekly and monthly reporting – with an emphasis on performance analysis
- Assets and tools management

### **Capacity building and empowerment**

Capacity building opportunities in a company like the QSCs represent real opportunities to contribute to the development of capacity in South Africa. The QSC's through the mentor companies will develop skills and management capacity. In addition, the structure of the QSCs will enable the owner-operator to benefit financially from the skills they develop through the ownership of the QSC.

Qinos, in co-operation with CJ Wilkinsons, will provide a range of training sessions and ongoing training to provide support and opportunities for growth to all six QSC's employees. These will include:

- Business practice and ethic;
- Motivation and confidence building;
- Oral and written business communication skills;
- Internal and external organisation networking;
- Customer and contract management skills;
- Personal financial management;
- Business financial management and budgeting
- Building and maintaining business relationship; and

## **Initial business offer**

The QSC business shall be split into the following categories:

- Installations
- De-installations
- Preventative maintenance and corrective maintenance
- Base stations maintenance

The first two categories relates to the acceptance of protocols and installing or removing all lottery equipment at the retailer premises. The third category relates to testing and replacement of terminals or other electronic devices and preventative maintenance at the retail outlet, the servicing and cleaning of the defective terminals or units and the shipping/freighting of the defective terminals to the Qinos Warehouse for shipping to Uthingo Repair Centre for sophisticated analysis problems and board level repairs. The final category relates to the first line of maintenance of base stations to either change a master radio or to determine the status of the IDU.

### **5.8. Assumption used in the Business Plan**

The main assumptions included in the financial projections above are as follows:

- Projections

The financial model is based on a period of one year. The three years is the anticipated remainder of the length of the lottery licence. It is anticipated that each QSC will become a sustainable business during the last two years of the term of the licence and will have business life well past the two years included in the model.

- Revenue

The six QSCs will have a contract with Qinos, which in turn has a contract with Uthingo for the Regional Field Maintenance Services. The field maintenance charge will be based on per terminal charge. The charge differs for each size of QSC based on the number of terminals the RFS is supporting and the vastness of the zone. Zones shall be classified large, small or medium QSC. In addition, the QSC will charge Qinos for the installation of terminals, de-installations, base station maintenance and shopfit maintenance. The ongoing field maintenance service based

on the average number to terminal owned by Uthingo. The ongoing charge will be adjusted on an annual basis not exceeding CPI.

No account has been taken in the financial model of the additional revenue that the QSCs can earn from additional contracts.

- Facilities

Each QSC will share the warehousing, central dispatching and calls administration, which shall be base in Durban. Any QSC who for operational reasons require an office space shall be assisted to secure one, which shall not exceed R1500 for the first year of operation.

- Personnel

The main operating costs of each QSC are personnel and infrastructure. The number of employed by the QSCs is detailed above. The personnel costs are inclusive of the salaries and wage, pension contributions and all other personnel related costs.

- Inflation

No inflation has been assumed in the model inline with the base case of Qinos. The CPI will adjust the costs and the revenue during the term of the contract.

## **5.9. Accounting Policies**

Financial Statements will be prepared in accordance with generally accepted accounting practices and the Company's Act. The particular policies to be adopted are described below:

- Revenue

Revenue is recognised as the services are performed.

- Start-Up Costs

All start-up costs (Costs incurred during the period of business development and infrastructure acquisition) are included in the QSC financial model.

- Taxation

The charge for taxation is based on the profit for the year. Deferred taxation is accounted for in respect of timing differences between profit as computed for taxation purpose and profit as stated in the accounts to the extent that such differences are expected to reverse in the foreseeable future.

- Fixed Assets and Depreciation

Fixed assets are stated at cost less depreciation. The Company's policy is to write off the cost of assets evenly over the shorter of the estimated use life or five years. Computer equipment shall be amortized over two years.

- Leasing

Fixed tangible assets acquired under finance lease are included in the cash flow statement as a monthly operational cost.

- Stocks

There is no stock to be valued since QSCs are not expected to purchase any stock.

## **5.10. Discussion of Operations**

The field maintenance performed by the QSCs will include the swap of terminals (including modules e.g. printer and reader), and radios.

### **Qinos Service Centre procedures and efficiency**

The establishment of the QSCs will be based on procedures developed by Uthingo and includes the following:

- Field Maintenance Procedure Guidelines
- Preventive Maintenance Procedures
- Installation Procedures
- Inventory Tracking Procedures
- Call dispatch Procedures
- Reporting Procedures



- General housekeeping Procedures
- Invoicing procedures
- Base stations maintenance procedures

In order to control the efficiency of the QSCs operations, the following reports will be generated on the regular basis:

- Financial status reports (including payroll, liabilities and monthly expenses)
- Vehicle maintenance records
- Personnel appraisals
- Standby register
- General housekeeping register
- Zonal Field Service Center Performance Summary
- Terminal maintenance Report (including radio and preventative maintenance)
- FAR Report (Field Activity Report)
- Inventory Report
- Current Stock Report
- Personnel Efficiency Report

In addition, Qinos and CJ Wilkinson will perform ongoing performance reviews in order to evaluate the efficiency of operations and to introduce methods of improving field maintenance, management and repair logistics.

### **Repair Logistics and Administration**

Uthingo will deliver and collect terminals and GVTs to and from the National Repair Centre. The transportation between Qinos and the six QSCs service will be arranged once a week. The cost of the transportation will be borne by Qinos.

### **Inventory control**

The QSC will maintain a stock registered that is updated on a daily basis and submitted once a week for reconciliation by Qinos. All equipment received must be accounted for.

## Security

The QSC will maintain strict physical security procedures, including Netstar early warning system, ID badges, maintaining confidentiality of customer information.

The QSC shall be expected to sign confidentiality and non-disclosure agreements, and all other agreements and compliance procedures that Uthingo imposes on Qinos from time to time, without exception.

### 5.11. Future Growth

With the increase in the use of technology in the world accompanied by the ever-increasing demand for after sales service and maintenance at the customer premises, each QSC will be well placed to benefit from these developments. Each QSC will further be in a position to benefit from the rapidly growing tendency to outsource service of the type in which it specialises.

The strategy allows of horizontal integration of services in the sense that the company can provide a range of field services without being constraint by the need to train its own personnel on the technology know-how required. The company can then restructure its management to suit the following arrangement:

- ❖ **Division A:** Lottery equipment field service and maintenance. The personnel with the skills required are already available. The only requirement is to convert them into subcontractors or have other companies employ them and then subcontracting to Qinos. Appendix G shows the projected cash-flow analysis for 2004/2004 to be very profitable.
- ❖ **Division B:** Telecommunications networks field service and maintenance. This function is already outsourced to Akha-Unique Telecoms and business opportunities are available for expansion of the contract or to bring on board new players as subcontractors.
- ❖ **Division C:** IT field service and maintenance. Again, this function is already outsourced to Webcore and the relationship is good. The scope of the contract can be extended in the event that new contracts are signed. In the event that Webcore does not have the competencies to provide a required service, then other players can be brought in to perform those tasks.

- ❖ **Division D:** Electronic equipment maintenance. This function is currently not amongst Qinos activities. However, there are lots of opportunities in security surveillance, alarms, security gates and electronic doors.

### **Key Considerations**

- ❖ Qinos must appoint experienced supervisors/field service managers per division to look at the management of the particular division in relation to the service level agreement with the particular vendor.
- ❖ The company accountant must spend at least two hours per month with each of the subcontractors making sure that their financial reports are in place and thereby ensuring that the subcontractor is sustainable in the long term.
- ❖ In every service level agreement that Qinos enters into, a clause on training and retraining must be included.
- ❖ Qinos must retain one of the zones for continuous research and development. Such a zone can also be used to benchmark the quality of service provided by the subcontractors.

In this way the company can be in a position to ensure that its subcontractors provide quality of services to the customer and the company is growing. On the other hand, previously disadvantaged blacks are gradually introduced to entrepreneurship through a mentoring programme which can go as far as standing surety for those subcontractors who might be in dire need of the start-up capital through finance institution such a Sizanani and Khula Financial Services.

Sizanani, for an example offers loans from between R10 000 and R50 000 to small micro enterprises that are trading from formal business premises and with the understanding that the owner of the of the business is actively involved in the running of the business on a full time basis. An application costs a non-refundable R200. No security is required and interest rates are charged at six (6) percent. Sizanani provides mentorship through mentors who earn R1250 for every loan approved and a further R4 250 for doing after care over two years on monthly basis.

## 5.12. Conclusion

The fundamental argument surrounding this argument is that of thinking 'outside the box' which, means that the management at Qinos are not restricted in terms of thinking that each strategic option is totally independent of the other. The similarities and differences between the two options are highlighted above. Both have their advantages and disadvantages. As a small company, Qinos needs to be innovative if it wants to address it's own business survival whilst at the same time taking up a massive challenge of black economy empowerment. The establishment of a network of subcontractor that are less expensive to create yet dependent on vendor specific training could create a niche in the outsourcing of ICT field service sector that could see Qinos grow bigger.

The beauty of this strategy lies in its flexibility and adaptability to suit all kinds of market conditions. It encourages entrepreneurship, job creation and skills transfer. More importantly is that the strategy promotes business growth and private ownership hence addressing some of the weaknesses in the previous BEE deals, which benefited only a few elite blacks.

## **Bibliography**

1. Amarath, M. (2003). 'Foreword' in the Franchising Book of Southern Africa 2003. Braamfontein: Franchise Association of South Africa.
2. Ambrosini, V with Johnson, G and Scholes, K. (1998). Exploring Techniques of Analysing and Evaluation in Strategic Management. Essex: Prentice Hall.
3. Barber, J. (1997). 'What is franchising?' in The Franchise Book of Southern Africa 1997. Eleventh Edition. Braamfontein: Franchise Association of South Africa.
4. Bishop, B. (2000). The Strategic Enterprise: Growing business for the 21<sup>st</sup> century. Toronto, Stoddart.
5. Black IT Forum, November 2003, pg. 14
6. Blumberg, M. and Devine, A. (2003). Fighting back in uncertain times, Service Management Magazine – December.
7. Bragg, P. (2002). The ethics of franchising. Succeed, September/November 2002, pg. 89.
8. Buttler, D. (2001). Business Development. Oxford: Butterworth Heinemann.
9. Campbell, D. et al (2002) Business Strategy. 2<sup>nd</sup> Edition, Oxford: Butterworth-Heinemann.
10. Campbell, D., Stonehouse, G. and Houston, B. (2002). Business Strategy. Oxford: Butterworth Heinemann.
11. Deneys, C. (2003). 'Franchising for the future' in Succeed November/December 2003, pg 74.

12. Doz, Y.L. and Hamel, G. (1998). *Alliance Advantage: The art of creating value through Partnering*. Boston: Harvard Business School Press.
13. Engelbrecht, K. (2003) 'Financial Security – Cornerstone of a successful franchise' in the *Franchising Book of Southern Africa 2003*. Braamfontein: Franchise Association of South Africa.
14. Fuoche, R. (2003). 'The importance of a Business Plan' In the *Franchising Book of Southern Africa 2003*. Braamfontein: Franchise Association of South Africa.
15. Fullerton, R. J. (2003) *Avoiding franchisor dissatisfaction, Succeed, May/June 2003*, pg78.
16. Gordon, B. (2003). 'Overview of the franchise sector' in the *Franchising Book of Southern Africa 2003*. Braamfontein: Franchise Association of South Africa.
17. Gonzaga, C. (2003). *The ethics of franchising. Succeed, May/June 2003*, pg76.
18. Haan de, K. (2003) 'Financial aspects to consider when starting a new franchise' in the *Franchising Book of Southern Africa 2003*. Braamfontein: Franchise Association of South Africa.
19. Hele, D. (2003). 'The secrets to a solid relationship' in the *Franchising Book of Southern Africa 2003*. Braamfontein: Franchise Association of South Africa.
20. Getz, K and Hessian, C. (2003). 'Overview of legal aspects of franchising' in the *Franchising Book of Southern Africa 2003*. Braamfontein: Franchise Association of South Africa.
21. Hall, P. and Dixon, R.(1988) *Franchising*. London: Pitman Publishing.
22. Ilbury, M. and Sutner, M. (2001). *The Mind of a FOX, Scenario planning in action*. Cape Town: University Publishers.

23. Johnson, J. (1999) Franchising as a mechanism for economic empowerment in South Africa, Master dissertation, Durban, University of Natal.
24. Lynch, R. (1997). Corporate Strategy. London: Pitman Publishing.
25. Manning, T. (2001). Making Sense of Strategy. Cape Town: Zebra.
26. Mathur, S.S and Kenyon, A. (2001) Creating Value: Successful Business Strategies. 2<sup>nd</sup> Edition. Oxford, Butterworth-Heinemann.
27. McGregor R. (2003). The ethics of franchising. Succeed, May/June 2003, pg78.
28. Mendelsohn, M. (1992) The Guide to Franchising. 5<sup>th</sup> Edition. London: Cassell Publishers.
29. Montgomery, C. (2000). True Liberty. Succeed, October/November 2000, pg.42.
30. Parker, E. and The Entrepreneurial Link, G. (2000). Flying without wings, Your take-off strategy to business wealth. Johannesburg: Entrepreneurial Link Publishers.
31. Parker, E. (2003). Pastel Profit, the power of information. Johannesburg: James Scott Business Brief. Vol. 3 No. 1.
32. Petts, N. (1997) Building growth on core competences – a practical approach, Long Range Planning, 30(4), 551-561.
33. Pirtle, B. (2000). How to buy a franchise in South Africa. Succeed, Oct/Nov 2000, pg.44.
34. Pitts, R.A. and Lei, D. (2000). Strategic Management. 2<sup>nd</sup> Edition. Ohio: South West College Publishing.
35. Prahalad, C.K. and Hamel, G. (1990) The core competence of the corporation. Harvard Business Review, May-June.

36. Sommerville, B. (2003). ' A sound business relationship – a two way expectation' in the Franchising Book of Southern Africa 2003. Braamfontein: Franchise Association of South Africa.
37. Qinos Board Minutes, 16 April 2003. Unpublished.
38. Qinos Board Minutes, 27 July 2003. Unpublished.
39. Qinos financial statement, July 2002 to March 2003. Unpublished.
40. Qinos strategy document, March 2001, Unpublished.
41. Qinos strategy document, March 2003, Unpublished.
42. Rackham, N., Friedman, L. and Ruff, R. (1996). Getting Partnering Right: How Market leaders Are Creating Long-Term Competitive Advantage. New York: McGraw-Hill.
43. Reich, R.B. and Mankin, E.D. (March –April 1986). Joint Ventures with Japan Give Away Our Future: Harvard Business Review., 78 – 86.
44. Ryan, S.D. and Harrison, D.A. (2000). Considering Social Subsystem Costs and Benefits in information Technology Investment Decision: A view from the Field of Anticipated Payoffs. Journal of Management Information Systems, 16(4), 9 –14.
45. Sandamela, V. (2002). A strategy for future growth. Succeed, September/October 2002, pg. 67.
46. Sukati, J. (2003) Sunday Times Business Times, 27 April 2003.
47. Thompson, Jr., A.A. and Strickland III, A.J. (2003). Strategic Management. Thirteenth Edition. Boston: McGraw-Hill Irwin.
48. Uthingo Mangement Strategy Document, September 1999, Unpublished.



49. Wickman, P.A. (1998) *Strategic Entrepreneurship: A Decision-Making Approach to New Venure Creation and Management*. London: Pitman Publishing.

## **APPENDIX A**

### **PREVENTATIVE MAINTENANCE**

#### **1. QINOS THIRD WORLD TECHNOLOGIES DUTIES**

- 1.1 Qinos Third World Technologies obligations in terms of the preventative maintenance service are those set out in this annexure.
- 1.2 Qinos Third World Technologies shall provide the services set out in this annexure in accordance with the provisions of this annexure.

#### **2. SERVICE DESCRIPTION**

- 2.1 Qinos Third World Technologies Manager shall prepare the preventative maintenance schedule per installed ISYS Terminal and shall dispatch the preventative maintenance cycles in the relevant area.
- 2.2 Preventative maintenance procedures **OPS1-P-007** as prescribed by Uthingo must be adhered to.
- 2.3 The three preventative maintenance cycles will be April – July, August – November and December – March to coincide with Uthingo’s financial year.
- 2.4 Cleaning materials as prescribed by Uthingo from time to time must be used during the preventative maintenance services. The cost of cleaning materials will be born by Qinos Third World Technologies.
- 2.5 Qinos Third World Technologies shall adhere to the procedures set out in clause 2 unless otherwise agreed to in writing by Uthingo.

#### **3. SERVICE LEVEL TIMES**

- 3.1 Preventative maintenance for ISYS terminals will be performed 3 (three) times at regular intervals during each 12 (twelve) month period commencing within 4 (four) months from the installation date.

#### 4. SERVICE MEASUREMENT

- 4.1 Preventative maintenance will be measured annually.
- 4.2 Total number of preventative maintenance required annually will be calculated based on an average of the monthly terminal figure invoiced times three.
- 4.3 Measurement will be a percentage calculated based on the total number of preventative maintenance achieved against total number of preventative maintenance required.

#### 5. SERVICE PRICING

- 5.1 An amount of R90.00 (ninety) per ISYS Terminal based on the number of ISYS Terminals installed with the status '**Active Retailers**' on the last Monday of the month in question.

#### 6. SERVICE PENALTIES

- 6.1 All penalties will be applied in arrears. Monthly-accumulated performance will be reported and confirmed with the Qinos Third World Technologies manager.
- 6.2 Qinos Third World Technologies will forfeit the calculated percentage of 'Not achieved preventative maintenance' tickets against the invoice amount for PM services within the reported period.

<b>EXAMPLE:</b> PM Invoice amount for year	=	R100 000.00
PM's required	=	1000
PM's achieved	=	950
Service level achieved	=	95%
Not achieved PM's %	=	5%
Penalty	=	5% of R100 000.00
Penalty Rand Value	=	R5 000

- 6.3 Penalty amount due will be deducted from Qinos Third World Technologies April month's invoicing after written agreement has been reached between Qinos Third World Technologies Manager and Uthingo Technical Services Manager. Uthingo's finance department will supply a copy of written agreement on penalties as proof of deductions.

# APPENDIX B

## QTWT EMPLOYEE RELATIONS CLIMATE REPORT

### DETAILED RESPONSES FROM THE STAFF

#### 1. FOCUS OF QTWT

- Installations
- Preventative maintenance
- Site surveys
- Removals of terminals
- Service Work Base Stations
- DE - Installations

#### ADMINISTRATIVE LEG

- Receiving of calls
- Allocating them to technicians
- Stock take and stock confirmation
- Payroll
- Provide two way information in the absence of the Boss
- Service WBS

#### 2. ROLE OF TECHNICIANS WITHIN QTWT

- Provide the service as tabled on point no. 1

#### ROLE OF ADMINISTRATION WITHIN QTWT

- \* Provide the services as tabled on point no. 1

#### 3. THINGS THAT MAKE STAFF HAPPY

- Salary
- Training on pastel
- Exposure and challenge
- Reception from external clients
- Team spirit
- The fact of having a Job
- Transport assistance

#### **4. STAFF CONCERNS**

- Communication that is poor
- Salaries that have not increased since 2001
- Clear lines of supervision
- Lack of incentives
- Lack of feedback on company performance
- One level, no opportunity for promotion
- The job no more challenging
- Lack of information on overtime calculation
- Changing job descriptions with no consultation
- Reconciliation : Monday figures on stock control

#### **5. PERCEIVED PROBLEMS OF THE ORGANISATION**

\* The organization is doing well in servicing the needs of clients.

#### **6. CLIENT'S CONCERNS ABOUT THE ORGANIZATION**

Clients see QTWT as Uthingo and therefore do not separate the problems given by Uthingo from QTWT

- Unfulfilled promises on incentives for providing the service on behalf of Uthingo
- Additional cost because of intensive security on Wednesdays and Saturdays
- Bank charges on money that do not belong to them
- Commission that is not attractive
- New installations taking too long

#### **7. SERVICES EXPECTED FROM THE ORGANIZATION**

- Prompt service
- Availability when there is a problem

#### **8. STAMBLING BLOCKS IN MEETING THOSE NEEDS**

- Clients not sure of who to talk to as there are various departments
- Hot line being centrally situated: take longer to be refereed to the appropriate service provider

**9. FEELINGS OF STAFF ABOUT MANAGEMENT**

- No transparency
- No two way communication
- Unable to complain about the administrator because of the relationship
- Lack of trust on the staff
- Other technicians given preferential treatment
- No consultation when implementing new systems or processes

**10. HOW FAR DO YOU WITH THE STATEMENT**

About 95% of the staff shared the same feeling about management

**11. RATE THE ORGANIZATION ON MEETING THESE NEEDS 1 – 5**

About 85% of the staff rated the organization between 1.5 – 2 out of 5 points on how positive they felt about the organization.

**12. WHAT IS THE SOLUTION IN YOUR UNDERSTANDING**

**THREE ISSUES THAT WOULD IMPROVE THE SITUATION DRASTICALLY**

- \* Salaries : any percentage increase on a year on year would make them feel recognized.
- \* Communication: : An effective two way communication would provide a forum for consultation and an environment that promotes participative co-determination
- Structure /supervision: Addressing the reporting lines and clarifying the role of the administrator would improve the situation



P. O. Box 15206  
Bellair  
4006

11 Belmuir Place  
Bellair  
4094

Tel. / Fax. 031 - 4633079  
E. Mail: [schiliza@worldonline.co.za](mailto:schiliza@worldonline.co.za)

**INFOTEAM INVESTMENTS 7 cc**

CK NO. 2001/030114/23

D.B. NO. INFO 002 ZNT

VAT. NO. 476/201121

**DATE: 10 APRIL 2003**

**ATTENTION : Mr M. Mkhonza**

As per the discussion on Friday, April 4, 2003 please receive the detailed report on staff comments due on Friday, 11 April 2003. The summarized report and comments was submitted on Monday, 7 April 2003. I will be presenting the proposed action plans to you Sir, by the 18<sup>th</sup> as planned.

Kind regards

STHABISO CHILIZA  
INFOTEAM INVESTMENTS



APPENDIX C

85 Bute Lane -- Sandown 2195 -- Sandton -- P. O. Box 652400 -- BENMORE 2010 -- South Africa  
Telephone: 27 (0)11 269 8763 -- Fax: 27 (0)11 269 8781

Mdu Mkhonza  
Managing Director  
Qinos Third World Technologies  
P O Box 401194  
Redhill  
4071

23 July 2003

Dear Mdu,

### JOB EVALUATION RESULTS

I have audited the evaluations carried out on 21st July 2003 at your premises in Durban according to the standard audit criteria built into the system. I am satisfied that the results that are displayed in the table below are accurate and at the appropriate level, based on these audits. However, part of the process should involve a representative of QTWT going through the results in order to ensure that there is consistency between the positions evaluated, from a QTWT perspective. Once you have approved the results of the gradings I will provide you with the salary information as promised.

I believe that in all the evaluations the questions were dealt with in a fair and candid manner and that the process was accepted by all who participated. The results of the evaluations are listed below. The output from the JE Manager system is attached for your benefit. I would strongly recommend that each participant in the evaluation be given a copy of the "Question Trace" that relates to the evaluation they were part of. Where I have audited an evaluation, please provide the participants with both the original and the audited version of the "Question Trace". "Reward Levels" are the size of the job according to the JE Manager system. Reward levels can be correlated to any other evaluation system in the market. For your convenience I have included the equivalent Paterson grades.

Position	Name	Reward Level	Audited Reward Level	Paterson Level
Field Services Technician	Vusi	12	12	C1
Field Services Technician	Phila	10	10	B4
Field Services Technician	Bongani	11	11	B5
Field Services Technician	Sandile	10	10	B4
Field Services Technician	Khule	11	11	B5
Field Services Technician	Sanele	10	10	B4
Field Services Technician	Buhle	11	11	B5
Administration	Thabile	10	10	B4
MD	Mdu	17	-	D2



It is our recommendation that all the field service technicians be graded at the same level. We believe that the most appropriate level for the field service technicians is a Reward Level 11, or Paterson B5.

Based on the above recommendation, the following salary ranges are recommended:

Position	Base Salary			Guaranteed Package		
	Q1	Median	Q3	Q1	Median	Q3
Field service technician	R70,928	R84,900	R100,636	R79,515	R96,831	R114,527
Administration	R62,001	R75,349	R89,335	R70,957	R86,730	R103,307
MD	R184,256	R212,928	R259,465	R266,181	R323,652	R391,002

where base salary is the annual amount paid in cash to an employee, guaranteed package is base salary plus all benefits, including medical aid, retirement funding and car allowance.

At the Q1 level, 25% of companies pay below this level, at median 50% of companies pay below this level, and at Q3, 75% of companies pay below this level.

Should you have any queries in this regard, please contact me.

Kind regards,

**Andrew Dickson**  
**Consultant**  
**011 269 8817**  
**083 281 7275**

# APPENDIX D

Prepared by: Qinos Third World Technologies

OME STATEMENT : 01/04/2003 to 29/02/2004

ES		
SERVICE FEE INCOME	3,437,310.05	3,437,310.05
<hr/>		
ST OF SALES		
OPERATING COSTS - COST OF SALES	748,039.97	748,039.97
<hr/>		
GROSS PROFIT / (LOSS)		2,689,270.08
OTHER INCOME		
Discount Received for Cash	2.99	
Interest Received	8,696.94	
Motor vehicle Hire	5,176.75	
Insurance Recovered	3,144.63	17,021.31
<hr/>		
		2,706,291.39
EXPENSES		
Accounting Fees	41,556.97	
Accounting / Audit Fees	25,263.15	
Bank Charges	10,423.67	
Cellphone Expenses	92,836.47	
Cleaning	5,786.89	
Computer Expenses	14,331.36	
Consumables	15,838.08	
Conference Fees	4,057.02	
Consulting Fees	13,600.00	
Courier & Postage	623.42	
Donations	497.02	
Electricity & Water	5,543.71	
Entertainment Expenses	4,016.55	
Insurance	85,829.92	
Interest Paid	21,330.07	
LEASING CHARGES	11,383.10	
Motor Vehicle Expenses- Petrol	236,794.07	
Motor Vehicle - Tracking Devices	1,800.00	
STANDARD FULL MAINTENANCE LEASES	281,739.54	
Printing & Stationery	3,503.04	
Office Consumables	696.93	
Rent Paid	117,636.75	
Repairs & Maintenance	2,431.05	
Salaries & Wages	1,076,247.75	
Uniforms	1,184.63	
Security	2,933.00	
Staff Training	41,800.78	
Start Up Costs	168,812.28	
Telephone & Fax	43,781.12	
Telephonic Exchange Expenses	4,172.93	
Internet	1,447.38	
Travel & Accommodation	20,815.59	2,358,714.24
<hr/>		
TOTAL PROFIT / (LOSS) BEFORE TAX		347,577.15
TAX		
DIVIDENDS		
<hr/>		
TOTAL PROFIT / (LOSS)		347,577.15
<hr/>		

APPENDIX F

	April	May	June	July	August	September	October	November	December	January	February	March	
Number of sites	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	
Price	170	170	170	170	170	170	170	170	170	170	170	170	
Turnover	204000	204000	204000	204000	204000	204000	204000	204000	204000	204000	204000	204000	2448000
<b>EXPENSES</b>													
Bank Charges-Admin	600	600	600	600	600	600	600	600	600	600	600	600	7200
Audit Fees	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	18000
Accounting Fees	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12000
Bank Charges-Stannic	100	100	100	100	100	100	100	100	100	100	100	100	1200
Cellphone-Admin	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	84000
Computer Expenses	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	24000
Cleaning	500	500	500	500	500	500	500	500	500	500	500	500	6000
Consumables-Admin	500	500	500	500	500	500	500	500	500	500	500	500	6000
Conference Fees	300	300	300	300	300	300	300	300	300	300	300	300	3600
Consulting Fees	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12000
Courier & Postage	200	200	200	200	200	200	200	200	200	200	200	200	2400
Donations	500	500	500	500	500	500	500	500	500	500	500	500	6000
Electricity & Water-Admin	600	600	600	600	600	600	600	600	600	600	600	600	7200
Entertainment-Admin	500	500	500	500	500	500	500	500	500	500	500	500	6000
Insurance-Admin	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000	108000
Nashua Copier-Lease	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	15600
Vehicles	30,000	30,000	30,000	30,000	30,000	30,000	30,000	30,000	30,000	30,000	30,000	30,000	360000
Petrol	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000	216000
Motor Vehicle - R & Man	3,200	3,200	3,200	3,200	3,200	3,200	3,200	3,200	3,200	3,200	3,200	3,200	38400
Motor Veh Exp - Toll&Park-Admin	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	19200
P & S	400	400	400	400	400	400	400	400	400	400	400	400	4800
Office CONS	500	500	500	500	500	500	500	500	500	500	500	500	6000
Rent - Office	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	144000
Salaries Paid to Staff-Admin	67,000	67,000	67,000	67,000	67,000	67,000	67,000	67,000	67,000	125,000	67,000	67,000	862000
R & Man - Buildings	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12000
Workmans Compensation	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	72000
Medical-Aid-Admin	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	96000
Provident	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000	108000
Skills Development Levy-Admin	300	300	300	300	300	300	300	300	300	300	300	300	3600
Security	500	500	500	500	500	500	500	500	500	500	500	500	6000
Staff Training	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	19200
Uniforms-Admin	400	400	400	400	400	400	400	400	400	400	400	400	4800
Telephone & Fax-Admin	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	48000
Telephone Exchange	350	350	350	350	350	350	350	350	350	350	350	350	4200
TRAVEL & ACCOMODATION	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	18000
Internet-Admin	300	300	300	300	300	300	300	300	300	300	300	300	3600
<b>TOTAL EXPENSES</b>	<b>192,250</b>	<b>192,250</b>	<b>192,250</b>	<b>192,250</b>	<b>192,250</b>	<b>192,250</b>	<b>192,250</b>	<b>192,250</b>	<b>250,250</b>	<b>192,250</b>	<b>192,250</b>	<b>192,250</b>	<b>2365000</b>
<b>NET INCOME</b>	<b>11,750</b>	<b>11,750</b>	<b>11,750</b>	<b>11,750</b>	<b>11,750</b>	<b>11,750</b>	<b>11,750</b>	<b>11,750</b>	<b>-46,250</b>	<b>11,750</b>	<b>11,750</b>	<b>11,750</b>	<b>83000</b>

APPENDIX G

	APRIL	MAY	JUNE	JULY	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	TOTAL	AVERAGE
Total Number of sites	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200		
Price	170	170	170	170	170	170	170	170	170	170	170	170		
Total Turnover	204,000	204,000	204,000	204,000	204,000	204,000	204,000	204,000	204,000	204,000	204,000	204,000	2,448,000	
Outsourcing price	90	90	90	90	90	90	90	90	90	90	90	90		
Subcontractor Turnover	108,000	108,000	108,000	108,000	108,000	108,000	108,000	108,000	108,000	108,000	108,000	108,000	1,296,000	
Less operational costs	75,500	75,500	75,500	75,500	75,500	75,500	75,500	75,500	75,500	75,500	75,500	75,500	906,000	
Net Turnover	20,500	20,500	20,500	20,500	20,500	20,500	20,500	20,500	20,500	20,500	20,500	20,500	246,000	
Zones -PMB														
Number of sites	200	200	200	200	200	200	200	200	200	200	200	200		
Price	90	90	90	90	90	90	90	90	90	90	90	90		
Service Fee Income														
Maintenance	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000	216,000	18,000
FST	1,000	1,001	1,002	1,003	1,004	1,005	1,006	1,007	1,008	1,009	1,010	1,011	12,066	1,006
TOTAL SERVICE FEES	19,000	19,001	19,002	19,003	19,004	19,005	19,006	19,007	19,008	19,009	19,010	19,011	228,066	19,006
EXPENSES														
Cell phone	700	700	700	700	700	700	700	700	700	700	700	700	8,400	700
Consumables	50	50	50	50	50	50	50	50	50	50	50	50	600	50
Petrol	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	30,000	2,500
MV-Repairs & Maintenance	100	100	100	100	100	100	100	100	100	100	100	100	1,200	100
MV-Roll & Park	50	50	50	50	50	50	50	50	50	50	50	50	600	50
MV Tracking Device	135	135	135	135	135	135	135	135	135	135	135	135	1,620	135
MV Stannic	185	185	185	185	185	185	185	185	185	185	185	185	2,220	185
ND-251 872	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	34,800	2,900
Insurance Bakkie	500	500	500	500	500	500	500	500	500	500	500	500	6,000	500
Laptop	300	300	300	300	300	300	300	300	300	300	300	300	3,600	300
Tools	100	100	100	100	100	100	100	100	100	100	100	100	1,200	100
Rent Paid	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Salaries Paid to staff	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	10,000	5,000	5,000	5,000	65,000	5,417
PAYE	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	2,400	1,200	1,200	1,200	15,600	1,300
Uif	180	180	180	180	180	180	180	180	180	180	180	180	2,160	180
Medical Aid	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000	1,000
Provident	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	15,600	1,300
Skills Dev Levy	80	80	80	80	80	80	80	80	80	80	80	80	960	80
Telephone	100	100	100	100	100	100	100	100	100	100	100	100	1,200	100
Travel & Accom	320	320	320	320	320	320	320	320	320	320	320	320	3,840	320
Staff Training	200	200	200	200	200	200	200	200	200	200	200	200	2,400	200
Uniforms-Admin	50	50	50	50	50	50	50	50	50	50	50	50	600	50
TOTAL EXPENSES	16,950	16,950	16,950	16,950	16,950	16,950	16,950	16,950	23,150	16,950	16,950	16,950	209,600	17,467
PROFIT (LOSS)	2,050	2,051	2,052	2,053	2,054	2,055	2,056	2,057	-4,142	2,059	2,060	2,061	16,466	1,539



ADMIN														
Consumables-Admin	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000	1,000
Conference Fees	500	500	500	500	500	500	500	500	500	500	500	500	6,000	500
Consulting Fees	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	18,000	1,500
Courier & Postage	400	400	400	400	400	400	400	400	400	400	400	400	4,800	400
Donations	100	100	100	100	100	100	100	100	100	100	100	100	1,200	100
Electricity & Water-Admin	600	600	600	600	600	600	600	600	600	600	600	600	7,200	600
Entertainment-Admin	500	500	500	500	500	500	500	500	500	500	500	500	6,000	500
Vehicles	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000	10,000
Insurance-Admin	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	60,000	5,000
Nashua Copier-Lease	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200	14,400	1,200
Petro-Mdu	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	24,000	2,000
Motor Vehicle - R&Matigulu-Admin	400	400	400	400	400	400	400	400	400	400	400	400	4,800	400
Motor Veh Exp - Toll&Park-Admin	100	100	100	100	100	100	100	100	100	100	100	100	1,200	100
P & S	400	400	400	400	400	400	400	400	400	400	400	400	4,800	400
Office CONS	200	200	200	200	200	200	200	200	200	200	200	200	2,400	200
Rent - Office	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000	10,000
Salaries Paid to Coordinating Staff														
Chief Coordinator	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000	18,000	9,000	9,000	9,000	117,000	9,750
Operations Coordinator	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	10,000	5,000	5,000	5,000	65,000	5,417
Office Coordinator	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	8,000	4,000	4,000	4,000	52,000	4,333
R & Matigulu - Buildings	500	500	500	500	500	500	500	500	500	500	500	500	6,000	500
Paye-Admin	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	72,000	6,000
Uif-Admin	400	400	400	400	400	400	400	400	400	400	400	400	4,800	400
Workmans Compensation	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	24,000	2,000
Medical-Aid-Admin	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	36,000	3,000
Provident	4,500	4,500	4,500	4,500	4,500	4,500	4,500	4,500	4,500	4,500	4,500	4,500	54,000	4,500
Skills Development Levy-Admin	400	400	400	400	400	400	400	400	400	400	400	400	4,800	400
Security	500	500	500	500	500	500	500	500	500	500	500	500	6,000	500
Staff Training	500	500	500	500	500	500	500	500	500	500	500	500	6,000	500
Uniforms-Admin	150	150	150	150	150	150	150	150	150	150	150	150	1,800	150
Telephone & Fax-Admin	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	36,000	3,000
Telephone Exchange	350	350	350	350	350	350	350	350	350	350	350	350	4,200	350
Cellphones	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000	1,000
TRAVEL & ACCOMODATION	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000	1,000
Internet-Admin	300	300	300	300	300	300	300	300	300	300	300	300	3,600	300
TOTAL ADMIN EXPENSES	75,500	75,500	75,500	75,500	75,500	75,500	75,500	75,500	93,500	75,500	75,500	75,500	924,000	77,000
OTHER INCOME(Radios)	17,000	17,000	17,000	17,000	17,000	17,000	17,000	17,000	17,000	17,000	17,000	17,000	204,000	17,000
(Terminals Extra)	84,000	84,000	84,000	84,000	84,000	84,000	84,000	84,000	84,000	84,000	84,000	84,000	1,008,000	84,000
(GVTs)	750	750	750	750	750	750	750	750	750	750	750	750	9,000	750
TOTAL COMPANY INCOME	101,750	101,750	101,750	101,750	101,750	101,750	101,750	101,750	101,750	101,750	101,750	101,750	1,221,000	101,750
TOTAL NET PROFIT/LOSS	26,250	26,250	26,250	26,250	26,250	26,250	26,250	26,250	8,250	26,250	26,250	26,250	297,000	24,750
Less Tax (35%)	9,188	9,188	9,188	9,188	9,188	9,188	9,188	9,188	2,888	9,188	9,188	9,188	103,950	8,663
Net Profit	17,063	17,063	17,063	17,063	17,063	17,063	17,063	17,063	5,363	17,063	17,063	17,063	193,050	16,088