

**A Study of Franchising as a Growth Strategy in the Residential  
Alterations and Additions Building Sector**

by

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**27 August 2003**

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Due to the strategic importance of this research it would be appreciated if the contents remain confidential and not be circulated for a period of five years.

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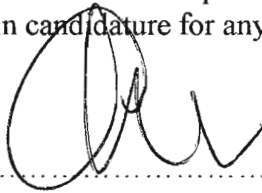
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9 SEPTEMBER 2003

STATEMENT

## **ACKNOWLEDGEMENTS**

Grateful thanks to the staff of the Planning Offices of both the North Local Council and Durban Central for their invaluable assistance in compiling statistics, to Mr P da Sylva for taking the trouble to email me the Valuation Roll for the Umhlanga area. Many thanks also to Roger Pickles of the Master Builders Association for his input.

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## **Abstract**

The building industry in South Africa especially in the sector of smaller operators in the residential alterations and additions market is subject to poor perception in the market place. The low barriers to entry and the attractiveness of the market make it susceptible to a large number of new entrants. The concomitant extreme rivalry has led to many cost cutting measures, creating an overall impression of lack of quality and poor standards. The ease of exit in this market has often left dissatisfied clients with no recourse or redress in rectifying poor workmanship and subject to an additional cost of hiring another builder to repair problems.

As a growth strategy, franchising has shown great potential over various types of industries. However, the building industry, and in particular the residential alterations and additions market has not been explored in this light. The most attractive feature of franchising as a growth option is the lack of capital required for the franchisor. The least attractive option is overcoming the seemingly fixed mindset of the public on price as the overriding factor when considering a contractor.

Experience in the industry has shown that advertising in the form of word of mouth is the most effective means of gaining new clients, however with the nature of franchising being more pervasive, it is envisaged that client awareness of the franchise will increase exponentially with each exposure in the form of building contracts.

To introduce a standard of quality and excellence in this market in a cost effective manner may be achievable through the introduction of franchising with its benefits of economies of scale, high management standards and, most importantly, the franchisee's will to succeed.

This work will investigate fully the ramifications of the franchising option, test the feasibility, acceptability and suitability of the strategy, making a final recommendation on the franchising model to be adopted, should the research validate the strategic option.

## Table of Contents

<b>CHAPTER 1: INTRODUCTION</b> .....	<b>1</b>
<b>1.1 Introduction</b> .....	<b>1</b>
<b>1.2 Background</b> .....	<b>1</b>
1.2.1 The RA&A Market.....	1
1.2.2 Franchising.....	3
1.2.3 Spencer Gore Construction.....	4
<b>1.3 Motivation for Research</b> .....	<b>6</b>
<b>1.4 The Value of the Research</b> .....	<b>9</b>
<b>1.5 Problem Statement</b> .....	<b>9</b>
<b>1.6 Objectives of Study</b> .....	<b>10</b>
<b>1.7 Research Methodology</b> .....	<b>10</b>
1.7.1 Qualitative.....	10
1.7.2 Methodology.....	10
<b>1.8 Limitations</b> .....	<b>11</b>
<b>1.9 Structure of Study</b> .....	<b>11</b>
<b>1.10 Summary</b> .....	<b>11</b>
<b>CHAPTER 2: THE FRANCHISING MODEL IN SOUTH AFRICA</b> .....	<b>12</b>
<b>2.1 Introduction</b> .....	<b>12</b>
<b>2.2 Franchisor Overview</b> .....	<b>14</b>
<b>2.3 The Entrepreneurial Flavour of Franchising</b> .....	<b>26</b>
<b>2.4 Franchising as a Black Empowerment Tool</b> .....	<b>27</b>
<b>2.5 The Benefits of Franchising</b> .....	<b>29</b>
2.5.1 Finance .....	29
2.5.2 Training .....	30
2.5.3 Group Benefits .....	31
2.5.4 Advertising.....	31
2.5.5 Purchasing Power .....	32
2.5.6 Other Administrative Functions.....	32

<b>2.6</b>	<b>Challenges of Franchising</b> .....	<b>32</b>
2.6.1	Franchisor Challenges .....	32
2.6.2	Franchisee Challenges .....	33
<b>2.7</b>	<b>Franchising Critical Success Factors</b> .....	<b>34</b>
<b>2.8</b>	<b>Conclusion</b> .....	<b>36</b>

**CHAPTER 3: CASE STUDY OF THE COMPANY AND THE BUILDING INDUSTRY WITHIN WHICH IT OPERATES..... 37**

<b>3.1</b>	<b>Introduction</b> .....	<b>37</b>
<b>3.2</b>	<b>Regulatory Bodies in the Building Industry</b> .....	<b>37</b>
<b>3.3</b>	<b>Market Analysis</b> .....	<b>40</b>
3.3.1	The Current Market .....	40
3.3.2	The Local (Durban) Market .....	43
<b>3.4</b>	<b>Competitor Analysis</b> .....	<b>46</b>
3.4.1	The Small to Medium Building Contractor .....	46
3.4.2	The Informal Building Sector .....	46
3.4.3	The Formal Building Sector.....	50
<b>3.5</b>	<b>Spencer Gore Construction</b> .....	<b>53</b>
3.5.1	Key Success Factors .....	53
3.5.1.1	Technology.....	53
3.5.1.2	Manufacturing.....	54
3.5.1.3	Marketing .....	55
3.5.1.4	Skills.....	55
3.5.1.5	Organisational Capability.....	55
3.5.1.6	Other.....	56
3.5.2	SWOT Analysis .....	56
3.5.2.1	Strength/Capability .....	56
3.5.2.2	Weakness/Deficiency .....	57
3.5.2.3	Opportunity .....	57
3.5.2.4	Threat.....	58
3.5.3	Weighted SWOT Analysis .....	58
3.5.4	Competitive Strength Assessment.....	59
3.5.4.1	Signs of Strength.....	59
3.5.4.2	Signs of Weakness.....	60
<b>3.6</b>	<b>Client Needs and Expectations</b> .....	<b>60</b>
<b>3.7</b>	<b>Conclusion</b> .....	<b>67</b>

<b>CHAPTER 4: PROPOSED FRANCHISING STRUCTURE</b> .....	<b>68</b>
4.1 Introduction .....	68
4.2 Franchise Design .....	68
4.3 Franchisor Requirements .....	71
4.4 Franchisee Requirements .....	72
4.5 Conclusion .....	73
<b>CHAPTER 5: RECOMMENDATIONS AND CONCLUSION</b> .....	<b>75</b>
5.1 Introduction .....	75
5.2 Attractiveness/Profitability of Industry.....	75
5.3 Industry & Competitive Analysis Summary .....	77
5.4 Industry Driving Forces.....	78
5.5 Performance Gap Analysis:.....	79
5.6 PIMS Analysis:.....	80
5.7 Strategic Options.....	80
5.7.1 Value Chain Analysis .....	81
5.7.1.1 Primary Activities.....	81
5.7.1.2 Support Activities .....	83
5.7.2 Industry Attractiveness Test.....	84
5.7.3 Competitive Strength Test.....	86
5.7.4 Strategic Fit Test.....	89
5.7.5 Resource Fit Test .....	90
5.7.6 Testing the Assumptions .....	91
5.8 Conclusion .....	91
<b>APPENDIX A: SAMPLE OF CLIENT QUESTIONNAIRE</b> .....	<b>94</b>
<b>APPENDIX B: THANK YOU LETTER TO CLIENTS</b> .....	<b>97</b>
<b>APPENDIX C: WINNER ADVERTISEMENT PLACED IN SUNDAY TRIBUNE</b> .....	<b>98</b>
<b>APPENDIX D: SAMPLE OF QUESTIONNAIRE SENT TO LOCAL BUILDERS</b> .....	<b>99</b>
<b>REFERENCES</b> .....	<b>100</b>



## List Of Tables

Table 2.1: Franchise Turnover by Category - BMI-Foodpak Baseline Census 2002 .....	15
Table 2.2 : Building Franchise Opportunities - www.frain.co.za.....	16
Table 2.3: Outlets Closed Down - BMI-Foodpak Baseline Census 2002.....	21
Table 2.4: New Outlets in 2001 Developed Locally - BMI-Foodpak Baseline Census 2002.....	23
Table 2.5: Average Capital Requirements - BMI-Foodpak Baseline Census 2002.....	25
Table 3.1: Building Plans Passed for Month Ended November 2002 - Statistics SA.....	41
Table 3.2: Contribution of KwaZulu Natal to Total Real Value of Building Plans Passed - Statistics SA.....	41
Table 3.3: Building Plans Passed According to Type of Building in KwaZulu Natal.....	42
Table 3.4: Buildings Completed According to Type of Building: Durban - Statistics SA44	
Table 3.5: Value of Alterations/Additions Courtesy of Figures Supplied by North Local Council.....	45
Table 3.6: Necessity for Training in Various Skills in the non-VAT-registered Building Sector .....	49
Table 3.7: Responses Elicited From Formal Sector Builders.....	52
Table 5.1: Competitive Strength Rating - Thompson Strickland (2003).....	89

## List Of Figures

Figure 1.1: 5 Generic Competitive Strategies.....	7
Figure 1.2: SWOT Analysis Diagram .....	8
Figure 2.1: Franchise Branded Systems - BMI-Foodpak Baseline Survey 2002.....	17
Figure 2.2: Franchised Branded Systems Excluding Company Owned - BMI-Foodpak Baseline Census 2002 .....	17
Figure 2.3: Number of Outlets Excluding Company Owned - BMI-Foodpak Baseline Census 2002.....	18
Figure 2.4: Provincial Outlet Split - BMI-Foodpak Baseline Census 2002 .....	19
Figure 2.5: Local vs. Internally Developed Franchised Branded Systems - BMI-Foodpak Baseline Census 2002 .....	19
Figure 2.6: Factors Affecting Growth Trends - BMI-Foodpak Baseline Census 2002 ...	23
Figure 2.7: Operational Problems - BMI-Foodpak Baseline Census 2002 .....	24
Figure 2.8: Owners by Age - BMI-Foodpak Baseline Census 2002.....	24
Figure 2.9: Capital Requirement - BMI-FoodPak Baseline Census 2002.....	25
Figure 2.10: Royalty Rate Calculation - BMI-FoodPak Baseline Census 2002.....	26
Figure 2.11: Owners by Culture - BMI-Foodpak Baseline Census 2002 .....	28
Figure 2.12: Bankers - Market Share - BMI FoodPak Baseline Census 2002 .....	30
Figure 3.1: Population Distribution of Persons Participating in the non-VAT-Registered Building Sector.....	47
Figure 3.2: Business Location of Operators in the non-VAT-Registered Building Sector .....	47
Figure 3.3: Employees in the non-VAT-Registered Building Sector With Either Written or Verbal Agreements .....	48
Figure 3.4: Employees in the non-VAT-Registered Building Sector with Paid Annual or Sick Leave.....	48
Figure 3.5: Employees in the non-VAT-Registered Building Sector With Either Paid Medical Expenses or Medical Aid Contributions .....	49
Figure 3.6: Weighted SWOT analysis.....	59
Figure 4.1: Franchise Design.....	70
Figure 5.1: Total NHBRC Registrations.....	87

## **CHAPTER 1: INTRODUCTION**

### **1.1 Introduction**

The construction industry in South Africa is made up of several divisions. There are the large civils projects, new housing, development projects, commercial construction, residential alterations and additions and commercial alterations and additions.

Throughout this proposal and dissertation the intended target market is that of residential alterations and additions, and for ease of use this will be referred to as the RA&A market, or target market.

The object of this research is to identify the problems associated with the RA&A market in general, in the light of both the smaller contractor and clients. Once these problems have been identified an investigation into how franchising may be utilised to solve these problems will be conducted.

Due to the fragmented nature of the market it is expected that a realistic solution will not emerge de facto and several extrapolations will have to be made from the data extracted. A working model of the franchise option will be subject to a viable franchise being set up and run for at least one year while the model is fine tuned to suit the market's particular requirements.

### **1.2 Background**

The background of the dissertation will focus on the RA&A market, franchising, and the company under discussion.

#### **1.2.1 The RA&A Market**

Finding a new way forward in the RA&A segment of the building industry is becoming more and more difficult. The low barriers to entry have created a surplus of operators who are prepared to cut prices to the bone in order to gain contracts. This has led to a perception of unreliability, poor quality and budget overruns.

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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The market itself is perceived as being extremely price sensitive with even the smallest client generally calling for at least three quotes and basing the choice of contractor on price alone. Because of this price sensitivity, the contractor is often forced to resort to non-ethical means of cost cutting in order to make a profit. This often includes withholding VAT, using inferior building materials and taking shortcuts when doing the actual work.

The natural progression from these cost cutting exercises is shoddy workmanship that reveals itself in cracked walls, uneven steps, uneven brickwork, etc. The client becomes very unhappy, refusing to accept the fact that he is often the author of his own misfortune, and so the cycle continues.

In the alterations and additions market there is no governing body as such. The NHBRC is the controlling body for new buildings only, providing a warranty for the new owner. The Master Builders Association is a voluntary association that governs its members only. The client, therefore, in this market, is basically on his own if he decides to go outside the MBA for a contractor.

As far as the smaller contractor is concerned, because the market is price sensitive, he is constantly sourcing cheaper materials and will often spend much of his time phoning various suppliers in order to get the best price possible.

The suppliers themselves are often unreliable, supplying inferior quality products and inflating prices. In some instances, such as cement and PVC, they are governed by the manufacturers, and especially in these two instances, frequent and high price increases impact severely on the costing of contracts.

The smaller contractor is also by and large hampered by a lack of administrative ability. Often known as a “bakkie builder”, the entire operation consists of the owner, a bakkie and a couple of labourers. With the advent of the cell phone it has become possible for him to remain in contact with his clients, but most of the time it is not an ideal means of

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## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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communication. Access to a fax machine is often not available, accounting systems are at best, haphazard and smaller contractors are notorious for unreliable creditors payments, causing them to lose settlement discounts. In addition, due to the low volumes of supplies ordered, they often do not qualify for best prices or best discounts.

Broadly speaking, the smaller contractor operating in the area of alterations and additions has very little opportunity for growth due to the many restrictions that surround his operation.

### **1.2.2 Franchising**

Franchising is a mechanism that is widely used to provide a low cost base growth strategy as opposed to organic growth or mergers/acquisitions. In essence a new franchise operation would offer excellent products or services, do market research regarding the demand for the product/service, establish a successful pilot operation and be able to produce a good track record regarding turnover and profits. The success of the operation would, in chief, be the result of the franchisor's expertise. Having done this, the franchisor would then be in a position to grant a license to interested parties usually for an initial fee and then more often than not, for a future royalty consideration.

The franchisor would offer expertise and market research, financial planning, training, support and more importantly, use of the corporate name. The franchisor would expect to exercise control over the franchisee in terms of maintaining the corporate image, quality, etc.

The benefits of franchising to the franchisor include quick expansion without utilising own capital, economies of scale, the ability to obtain better contracts, not only from suppliers but from buyers as well, and more motivated management.

In return the franchisee would expect support, training and market research, as well as technical expertise and ideas. Due to this support there is generally a lower risk to starting a franchise operation, although failures do occur. The franchisor would offer

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assistance in setting up the operation; the franchisee gains enormous benefit from bulk buying (if these full discounts are passed down the chain), marketing and reputability from the brand name. Advertising would be done by the franchisor ensuring frequent and prevalent coverage.

There are of course, disadvantages to the franchisee. For instance they would not be their own boss, and because of this franchisees are often known as “soft entrepreneurs”. They would be expected to conform to a uniform image. Royalty payments can be a contentious issue if the franchisor is perceived as not living up to his part of the bargain. Franchisees are limited in the disposal of their business, franchisors having the right to vet the proposed buyer. The contract period is generally renewable every five to ten years and the franchisor can refuse to renew the option if the franchisee is not performing satisfactorily. On top of this, the franchisor can close down, often due to under-capitalisation of the business. Financial constraints may also cause the franchisor to not fulfill the promise of sufficient support, advertising or even stock supply.

It is imperative that, in order for the franchise operation to be successful, the franchisor should be in a position to offer an excellent product or service, have done market research regarding the demand for the product or service and have run a successful pilot operation showing good turnover and profits. The franchisor must be prepared to show potential franchisees specimen profit projections and a three-year business plan. The success of the operation relies on the management expertise of the franchisor and it is up to him to ensure that the royalty fee payable by the franchisees is worth the support and services on offer.

### **1.2.3 Spencer Gore Construction**

Spencer Gore Construction commenced operations in 1992 in the town of Harding ±200km from Durban, developing approximately 150 serviced sites owned by the Harding Town Board. The costs of operations were low and large profits were made. Approximately 8 houses were built per month. By 1994 Spencer Gore Construction was looking for new opportunities to expand the business. These were found in Margate and

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## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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later in Newlands East in the same market, and operations commenced in these areas in 1994 and 1995 respectively.

Spencer Gore Construction then decided to look at alternative building markets and began tendering on government jobs. While initially successful it soon became apparent that the profit margins on these contracts did not afford sustainable revenue for a smaller construction company but the work did however provide a track record of credibility.

In 1997 a townhouse development was identified in the Cape Town area. Unfortunately the development bank changed their lending criteria and the development was abandoned with a subsequent substantial loss.

Spencer Gore Construction then decided to focus on the KwaZulu Natal area, building exclusive houses of + R 1 million. It was at this time that the economy started to fall and the building industry collapsed, with competition increasing and, even though the company was getting work, it was at much lower prices than was considered profitable. They subsequently decided to concentrate on the Durban area only.

The market in Durban at that time was especially poor and very low margins were available. Building on their previous experience in the middle to low cost housing sector, Spencer Gore Construction commenced development in the Lovu Reconstruction and Development Project in Kingsburg area and to date over 200 houses have been built in this area, a success only achieved through constant dedication to the needs of the client and after sales service. A reputation for honesty and reliability has been achieved in a market that is extremely difficult to penetrate successfully.

In conjunction with this, in 1998 the company identified the Internet as a hitherto unexplored avenue. A marketplace e-commerce site for the industry was conceived and the development of the software outsourced. An unforeseen merger in the US partnership complicated the deal and Spencer Gore Construction withdrew from the arrangement by mutual agreement. A very large amount of money was lost on the Internet venture.

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Since 2001 Spencer Gore Construction re-entered the more exclusive residential property market, identifying their core competence as that of service excellence and quality. In this market they have constantly strived to provide quality and high standards. The adherence to quality and not cost cutting in a price sensitive market appears to be paying dividends as the business runs on a reasonable profit margin and a base of satisfied clients is being built.

Spencer Gore Construction is now in the process of expanding their business model and new markets are being sought. The cash spent on the Internet business has, however, affected their ability to fund large developments. It is in this light that franchising as a growth option is being investigated.

### **1.3 Motivation for Research**

Growth in the RA&A building industry is hampered mainly by the highly competitive nature of the participants. As previously discussed, barriers to entry are low and the market is extremely price sensitive. This means profit margins are low and advertising is a luxury on the bottom line. The primary means of advertising is word of mouth and construction boards at project sites. Capital becomes difficult to accumulate unless a large project is undertaken where the company has sole access to the land and the development thereon.

The size of the market makes it very attractive to new participants with the latest Statistics SA figures showing an overall market in South Africa for additions and alterations in the dwelling house market for the period January 2002 to November 2002 at R4271,4 million – an increase of 21,9% over the previous period. The figures for KwaZulu Natal are R561,7 million, an increase of 23,7%, while Durban alone had a market of R328,7 million – an increase of 12,8%. (Statistics SA, 15 January 2003).

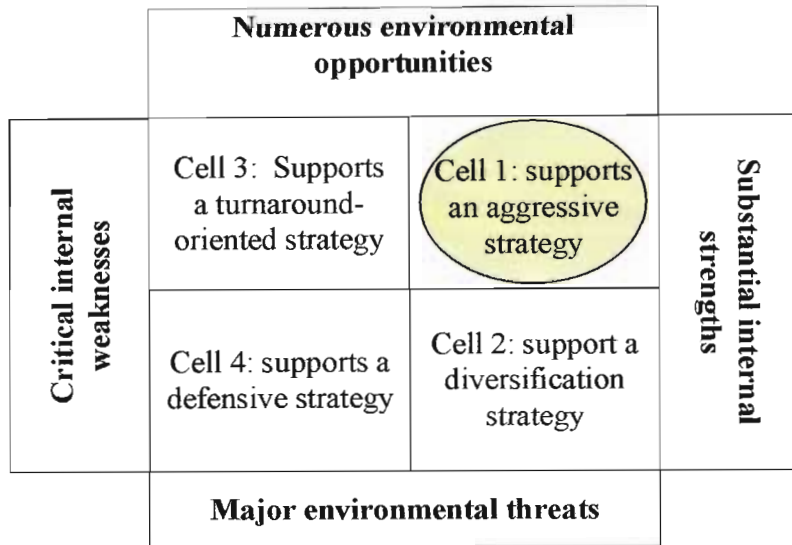


<b>Target Market</b>	<b>Broad cross-section of buyers</b>	Overall low cost leadership	Broad differentiation strategy
	<b>Narrow buyer segment or niche market</b>	Focused low cost strategy	Focused differentiation strategy
		<b>Lower Cost</b>	<b>Differentiation</b>
<b>Type of competitive advantage being pursued</b>			

**Figure 1.1: 5 Generic Competitive Strategies**

(Thompson Strickland, 2003)

If one examines the Generic Competitive Strategies matrix under Target Market the choice would be a narrow buyer market, while the type of competitive advantage being pursued would be both that of lower cost due to the price sensitive nature of the market and differentiation, being quality and excellence of service, the strategy would fall under Best cost provider strategy, in line with a franchising strategy.



**Figure 1.2: SWOT Analysis Diagram**

Thompson Strickland, 2003

In the context of a SWOT analysis there are numerous environmental opportunities as evinced by the statistics, and Spencer Gore Construction has substantial internal strengths as demonstrated by their ability to survive an industry slump and many reversals of fortune yet still maintain profitability. This points to supporting an aggressive strategy, once again supporting the franchising option.

In order to find a way forward in a market where it is difficult to maintain profitability while providing service and quality, it envisaged that franchising will provide the means of overcoming costing problems with economies of scale, not only in sourcing building materials but also in substantially lowering administrative costs of franchisees, while providing advertising coverage that would be hitherto unaffordable.

#### **1.4 The Value of the Research**

The writer has conducted exhaustive research both locally and internationally to attempt to find a working model for this type of franchise venture. While there are smaller franchise operations, for example The Blue Army in South Africa, these do not address the alterations and additions market per se. The emphasis is on recommending service providers such as plumbers, electricians, handymen, etc.

The benefit of the research being conducted would be to evaluate the viability and potential of a concerted growth strategy in a market that is currently highly fragmented and suffers from a lack of credibility. In addition to the obvious benefit of providing a reliable and credible operator in this market it is also perceived that it may be an effective black empowerment tool for new entrants into this market.

The benefit to Spencer Gore Construction will be demonstrated by the ability to grow exponentially with little capital outlay, utilizing their accumulated skills and knowledge base while adhering to their high standards of quality and excellence.

#### **1.5 Problem Statement**

Because of the problems of reliability, quality, maintaining high standards, meeting deadlines and sticking to clients' budgets it is suggested that a franchise operation may provide a way forward in the RA&A industry, adding credibility, providing more exposure and restoring high standards to this troubled sector of the building industry.

The question is therefore posed:

“How feasible is franchising as a growth strategy in the Residential Alterations and Additions Building Sector?”

## **1.6 Objectives of Study**

- To determine the feasibility of franchising as a growth strategy in the Residential Alterations and Additions Building Sector
- To evaluate the suitability of franchising as a growth strategy
- To establish the acceptability of franchising to the company

## **1.7 Research Methodology**

The nature of the project will focus on qualitative research methodology.

### **1.7.1 Qualitative**

- Secondary data
  - o Various business plans drawn up by Spencer Gore Construction
- Questionnaires
  - o Personal interview with Master Builders Association
  - o Questionnaire to clients regarding their experiences in the RA&A industry
  - o Questionnaire to contractors to attempt to establish problem areas and their priorities

### **1.7.2 Methodology**

A thorough analysis will be done of the RA&A industry including but not limited to restrictions, market place perceptions, competencies and opportunities. A generic franchise model based on research into the franchise industry will follow this. Once these parameters have been established the writer will draw up a franchise model based specifically on the RA&A industry requirements, detailing benefits and possible pitfalls.

A conclusion will then be extrapolated as to the feasibility, suitability and acceptability of the franchise operation for Spencer Gore Construction.

### **1.8 Limitations**

The study will be conducted in the greater Durban area, as this is the current operational area for Spencer Gore Construction.

Due to the highly competitive nature of the industry the validity of the responses from contractors approached cannot carry a high rating, but will nevertheless provide some illumination on the subject generally.

### **1.9 Structure of Study**

- Chapter 1 – Introduction
- Chapter 2 – The Franchising Model in South Africa
  - o Model
  - o Dependant variables
  - o Independent variables
- Chapter 3 – Case Study of Company and Industry within which it Operates
- Chapter 4 – Proposed Franchising Structure
- Chapter 5 – Recommendations & Conclusions

### **1.10 Summary**

The character of the RA&A market as well as the original nature of the study to be conducted is filled with variables and many unknowns. It is hoped that a new strategic option will present itself as a solution but without thorough research and analysis of the variables, the writer is reluctant to offer a prognosis of the outcome. It is hoped that the investigation of franchising will offer a way forward and provide a unique opportunity to Spencer Gore Construction to become an industry leader in the residential alterations and additions market and by so doing restore credibility and high standards, providing customer satisfaction and service excellence.

## **CHAPTER 2: THE FRANCHISING MODEL IN SOUTH AFRICA**

### **2.1 Introduction**

Franchising may be defined as an agreement between two legal entities, the franchisor and the franchisee, as follows: “the franchisor is a parent company that has developed some product or service for sale; the franchisee is a firm that is set up to market this product or service in a particular location.” (Castrogiovanni & Justis, 1998). They go on to describe the business format franchising concept as the “carbon-copy” format, with the key element being that of consistency by means of replication of the successful formula and controls in place.

The 2002 Franchise Baseline Census conducted by BMI-Foodpak ([www.frain.org.za](http://www.frain.org.za)), which analysed the state of franchising in South Africa, attributed R135-billion turnover to the franchise industry. The Sunday Times in April 2003 states that this makes franchising one of the fastest growing markets in the world, directly employing about 9399 people. Nic Louw, the executive director of the Franchise Association of Southern Africa was quoted in a further article in the Sunday Times (28 October 2001) as stating that franchising in South Africa has the ability to create jobs, boost the economy and survive economic pressures.

He goes on to say that he believes that franchising capitalizes on the growing trend towards entrepreneurship, with less emphasis on the formal and corporate sectors to provide jobs. Louw also believes that franchising is one of the most efficient ways that companies can grow distribution channels and profits. It is a business model most ideally suited to non-capital intensive businesses where funding barriers, infrastructure and setup costs are generally lower.

Franchising in South Africa is widely established, however, the market share is estimated at only 12% (Sunday Times, 11 February 2001). With the government backing franchising as a mechanism for empowerment, and the support of the Department of Trade and Industries, franchising is believed to be a viable tool in growing a company.

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## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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Bisseker (1997) is quoted as stating “the growth of the franchising industry results partly from large corporations using franchising as a way of unbundling and expanding”. It is seen as an alternative to retrenchment as well as a tool for black economic empowerment.

Barber (1997), states that “franchising has been described as a blend of “big and ‘small’ business: a fusion of the energy and commitment of the individual with the resources, power and strength of a large company. It is widely seen as a relatively safe way for people to get into business for themselves but not by themselves”. He goes on to state that for “companies to expand effectively without incurring the high overheads and management hassles usually associated with the establishment of a branch network”. He believes that franchising enables companies “to convert their existing branch or agency systems into lean and mean marketing machines”

Franchising is driven by the desire for flexibility and decreased overheads. Stanworth & Smith (1991) propose that franchising is suited to service and labour-intensive activities requiring a large number of geographically dispersed outlets serving local markets.

The success rate of franchising is very high. Van Huyssteen (1998) states “statistics show that the failure rate of established franchises is about 5%. The United States of America’s Department of Commerce traced the success of 100 independently owned businesses and 100 franchises over a ten-year period. At the end of year one, 97 franchises were still operating compared to 62 independent businesses. By the tenth year, 90 franchises were still going strong, but only 18 independent businesses survived”

Banks and lending institutions favour franchising as the business model is composed of researched and reliable information according to Maitland (1991). This is borne out in the South African model with financing being readily available to well-designed franchise outlets.

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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### 2.2 Franchisor Overview

Franchise Advice and Information Network ([www.frain.org.za](http://www.frain.org.za)) estimate that franchising in South Africa is currently growing at approximately 30 – 35% per annum, resulting in a current R34bn a year industry. In the United States alone a new franchise is opening every 8 minutes. It is seen as one of the dominant forms of organisations in our times.

The rising popularity of franchising is due to its effectiveness as a growth strategy for most business models. Franchise systems can be adapted and modified to suit most situations. It also makes a major contribution to the development of skills.

In order to propound the theory of franchising as a strategic option within the market specified, it is necessary to explore the acceptance of franchising and the success enjoyed by franchisors as well as franchisees in South Africa. To this end the Franchise Baseline Census 2002, undertaken by BMI-Foodpak has been used extensively to support the study.

Turnover by category		
Outlets	Total	Excluding Company Owned
Automotive	3 824 850 000	3 746 878 571
Building	5 842 820 000	5 451 003 239
Business to Business Services	2 545 530 000	2 504 650 635
Convenience Stores	5 061 491 518	4 895 560 136
Education and Training	501 403 000	387 859 839
Entertainment	312 650 000	271 804 301
Health and Beauty	416 150 000	401 646 423
Home Services	167 920 000	160 003 333
Information Technology	15 720 000	14 812 424
Other	1 927 320 593	1 856 602 799
Petroleum	56 386 259 200	56 386 259 200



A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

Turnover by category		
Outlets	Total	Excluding Company Owned
Photographic Products and Services	330 000 000	191 538 462
Real Estate	18 808 500 000	14 863 584 416
Restaurants	5 164 232 999	4 827 779 595
Retailing and Direct Marketing	2 576 600 000	1 471 843 025
Retailing Supermarkets	16 211 000 000	16 066 881 860
Take out	3 694 722 658	2 891 132 956
Telecommunication	10 000 000 000	9 914 871 795
Travel	1 953 000 000	1 952 000 000
<b>TOTAL</b>	<b>135 740 169 968</b>	<b>128 256 713 009</b>

**Table 2.1: Franchise Turnover by Category - BMI-Foodpak Baseline Census 2002**

The building industry turnover figure is estimated at R5,842billion or 4% of this amount. However, the franchised building sector consists of the following outlets:

Company	Opportunities	Investment	Category
Africotta Hand Made Tiles		R101,000 - R200,000	Building
Aldes Business Brokers		R101,000 - R200,000	Building
Coastal Tool Hire		R201,000 - R500,000	Building
CTM		R201,000 - R500,000	Building
Dock Hardware		R1 million or more	Building
Dulux Paint N Paper		R26,000 - R100,000	Building
Easyfit Cupboards		R201,000 - R500,000	Building
Inso Aluminium	Eastern Cape Kwazulu Natal Mpumalanga Limpopo Province Free State	R501,000 - R999,000	Building
Lokblok Retaining Systems		R201,000 - R500,000	Building
Lumber City	Eastern Cape Free State Kwazulu Natal Northern	R201,000 - R500,000	Building

A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

Company	Opportunities	Investment	Category
	Cape Limpopo Province North West		
Marble and Granite		R101,000 - R200,000	Building
Mica Build		R1 million or more	Building
Mica Hardware		R1 million or more	Building
Mr Poolman		R26,000 - R100,000	Building
On-Tap		R201,000 - R500,000	Building
Paint Afrika		R1 million or more	Building
Paint, Damp & Waterproof Specialists		R26,000 - R100,000	Building
Pave Seal		R26,000 - R100,000	Building
Plumbing & Electrical		R26,000 - R100,000	Building
Pool Craft		R101,000 - R200,000	Building
Proport Franchise		R201,000 - R500,000	Building
Randcon Paint Centre		R201,000 - R500,000	Building
San Afrika		R1 million or more	Building
Skonkwane Rural Hardware	Mpumalanga Limpopo Province	R201,000 - R500,000	Building
Tile Afrika	Western Cape Gauteng Kwazulu Natal	R1 million or more	Building
Timbercity		R201,000 - R500,000	Building
Timberland		R1 million or more	Building
Wilcote Franchising		R101,000 - R200,000	Building

**Table 2.2 : Building Franchise Opportunities - [www.frain.co.za](http://www.frain.co.za)**

The table shows the investment amount as well as the types of franchised systems available in South Africa. It is apparent from the table that the more established and successful the franchise is, the higher the investment. It is also apparent that there is no franchise in South Africa operating on the business model proposed in this document.

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

There were an estimated 393 branded franchise systems identified by the survey, of which 23 were in the building industry or approximately 6%.

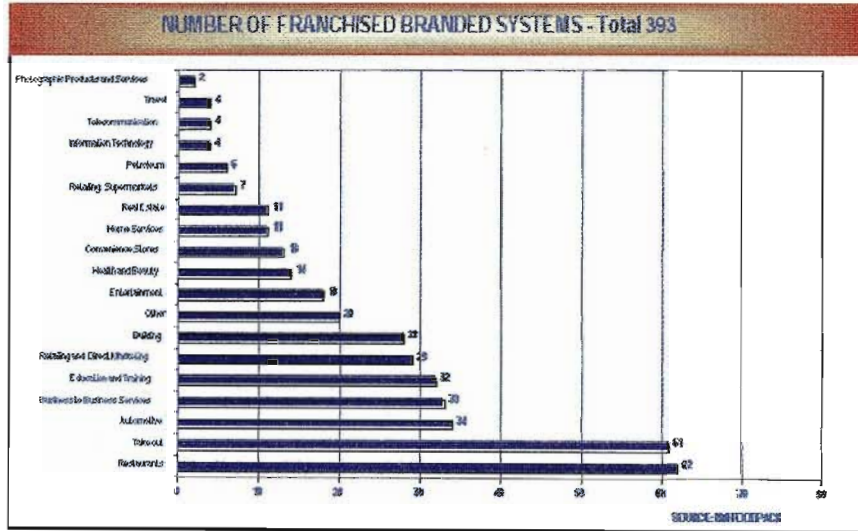


Figure 2.1: Franchise Branded Systems - BMI-Foodpak Baseline Survey 2002

The total number of outlets excluding those that are company owned are presented as follows:

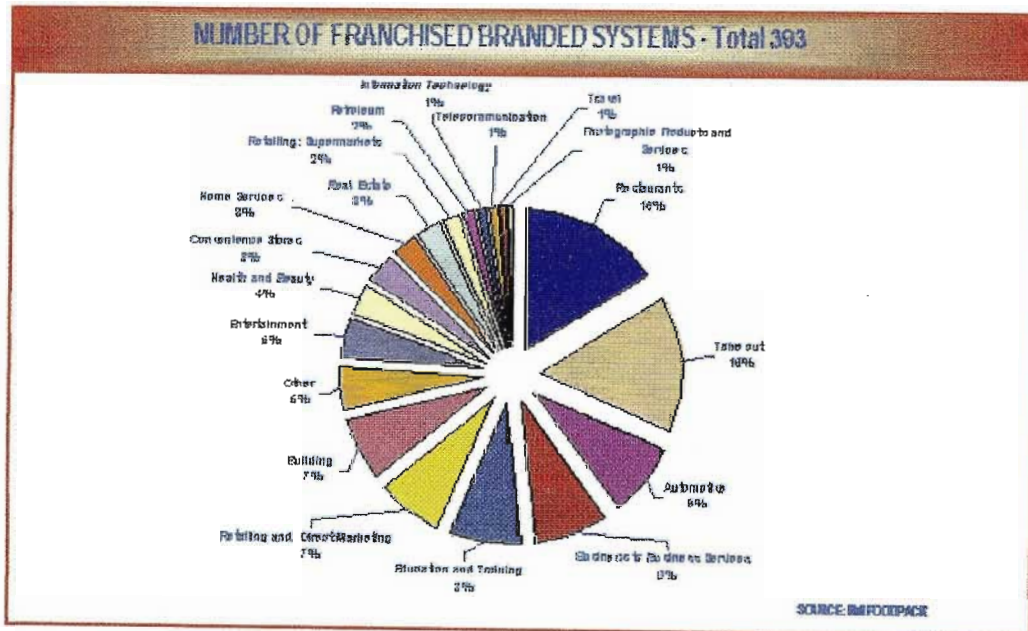
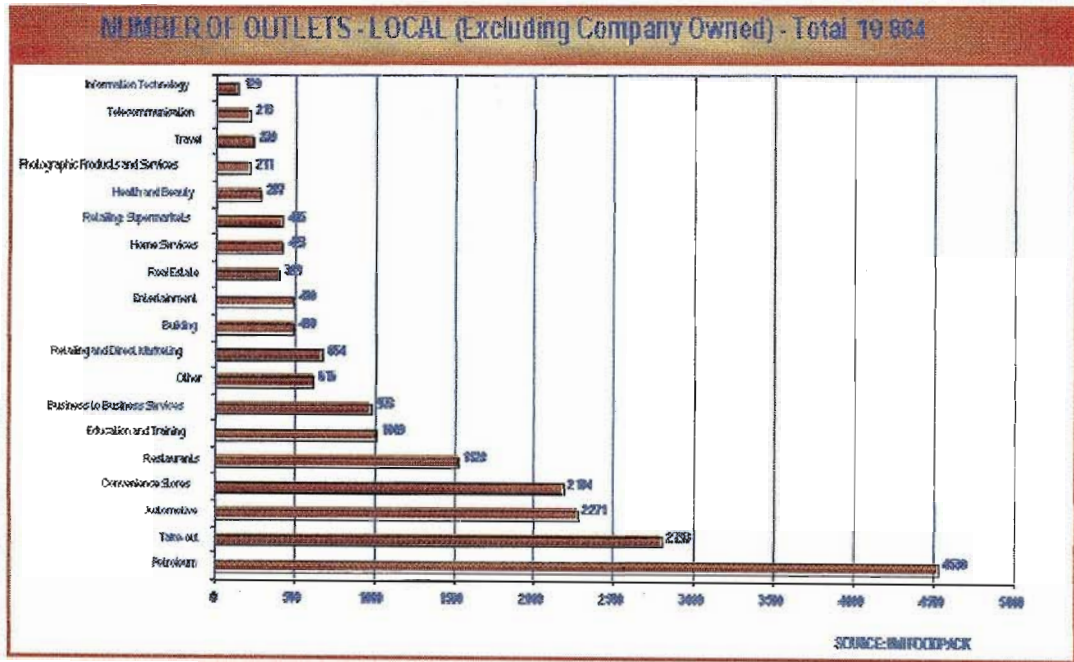


Figure 2.2: Franchised Branded Systems Excluding Company Owned - BMI-Foodpak Baseline Census 2002

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

The actual number of physical outlets of the branded franchises (excluding company owned outlets) in South Africa is depicted in the graph below:



**Figure 2.3: Number of Outlets Excluding Company Owned - BMI-Foodpak Baseline Census 2002**

Of the total 19864 outlets in South Africa, 490 of these related to the building industry, or 2%.

# A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

The Provincial outlet distribution is indicated as follows:

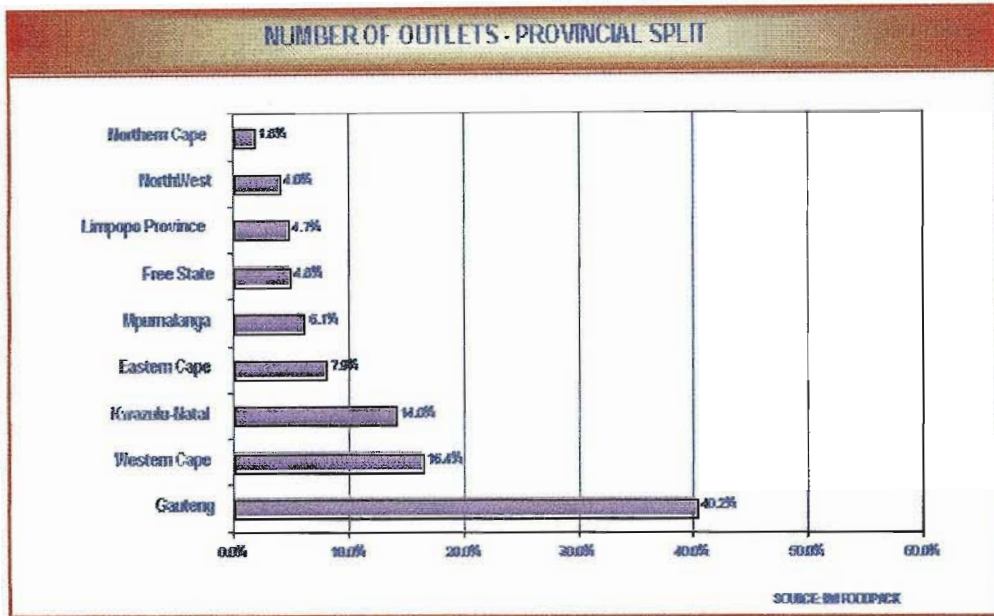


Figure 2.4: Provincial Outlet Split - BMI-Foodpak Baseline Census 2002

KwaZulu Natal shows a 14% penetration of total franchised outlets in South Africa.

Local franchised systems enjoy greater popularity or penetration than International ones.

This may represent an opportunity to utilize the “Proudly South African” banner.

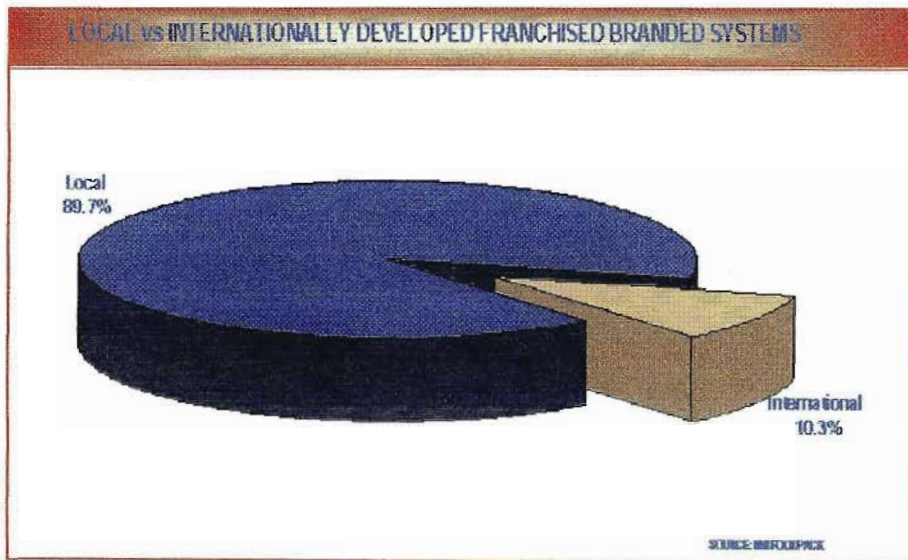


Figure 2.5: Local vs. Internally Developed Franchised Branded Systems - BMI-Foodpak Baseline Census 2002

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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It was estimated that approximately 389 outlets closed during the years 2000-2001, with 21 franchisors exiting the market in 2001 financial year. However approximately 3480 outlets opened. Locally branded systems were estimated in the region of 2581 in South Africa.

The table below demonstrates the ongoing attractiveness of franchising in South Africa, depicting the difference between the number of outlets closed as opposed to the number of outlets opened of locally developed franchises.

Outlets closed down		
Categories	Number	% of total
Automotive	33	8%
Building	28	7%
Business to Business Services	33	8%
Convenience Stores	13	3%
Education and Training	32	8%
Entertainment	18	5%
Health and Beauty	14	4%
Home Services	10	3%
Information Technology	4	1%
Other	19	5%
Petroleum	6	2%
Photographic Products & Services	2	1%
Real Estate	11	3%
Restaurants	62	16%
Retailing and Direct Marketing	29	7%
Retailing: Supermarkets	7	2%

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A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

Outlets closed down		
Categories	Number	% of total
Take out	60	15%
Telecommunication	4	1%
Travel	4	1%
<b>TOTAL</b>	<b>389</b>	<b>100%</b>

Table 2.3: Outlets Closed Down - BMI-Foodpak Baseline Census 2002

Of the 389 outlets closed, the Building sector consisted of 28 outlets, or 7%.

Number of new Outlets in Past Financial Year - 2001 - DEVELOPED LOCALLY				
Categories	Inter-national	Rest of Africa	South Africa	Grand Total
Automotive		21	252	273
Building: Retail	113	25	207	345
Building: Services			30	30
Business to Business Services: Other	1		81	82
Business to Business Services: Postal and printing		3	127	130
Convenience Stores		22	205	227
Education and Training	8	6	101	115
Entertainment		2	57	59
Health and Beauty			34	34
Home services	3	1	54	58
Information Technology			39	39
Other			8	8
Other: Accommodation			1	1

A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

Number of new Outlets in Past Financial Year - 2001 - DEVELOPED LOCALLY				
Categories	Inter-national	Rest of Africa	South Africa	Grand Total
Other: Burial Services			1	1
Other: Delivery			3	3
Other: Funerals			10	10
Other: Pharmaceutical			33	33
Other: Shoe Repair and Locksmith			10	10
Other: Spit Braai			1	1
Other: Veterinary			2	2
Petroleum		51	384	435
Photographic Products and Services			10	10
Real Estate		2	44	46
Restaurants: Burgers		5	39	44
Restaurants: Coffee		1	83	84
Restaurants: Italian	1	1	28	30
Restaurants: Other	1		19	20
Restaurants: Pubs	1		13	14
Restaurants: Seafood		1	11	12
Restaurants: Steak	2	4	37	43
Retailing and Direct Marketing		7	116	123
Retailing: Supermarkets		1	73	74
Take-out: Bakery		4	82	86
Take-out: Burgers		10	32	42
Take-out: Chicken	51	11	83	145
Take-out: Other		4	143	147



A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

Number of new Outlets in Past Financial Year - 2001 - DEVELOPED LOCALLY				
Categories	Inter-national	Rest of Africa	South Africa	Grand Total
Take-out: Pizza		5	47	52
Take-out: Seafood		2	30	32
Telecommunication		8	51	59
<b>Grand Total</b>	<b>181</b>	<b>197</b>	<b>2 581</b>	<b>2 959</b>

Table 2.4: New Outlets in 2001 Developed Locally - BMI-Foodpak Baseline Census 2002

The graph presents the 10 highest rated factors affecting growth trends as indicated by respondents covering the total franchise sector

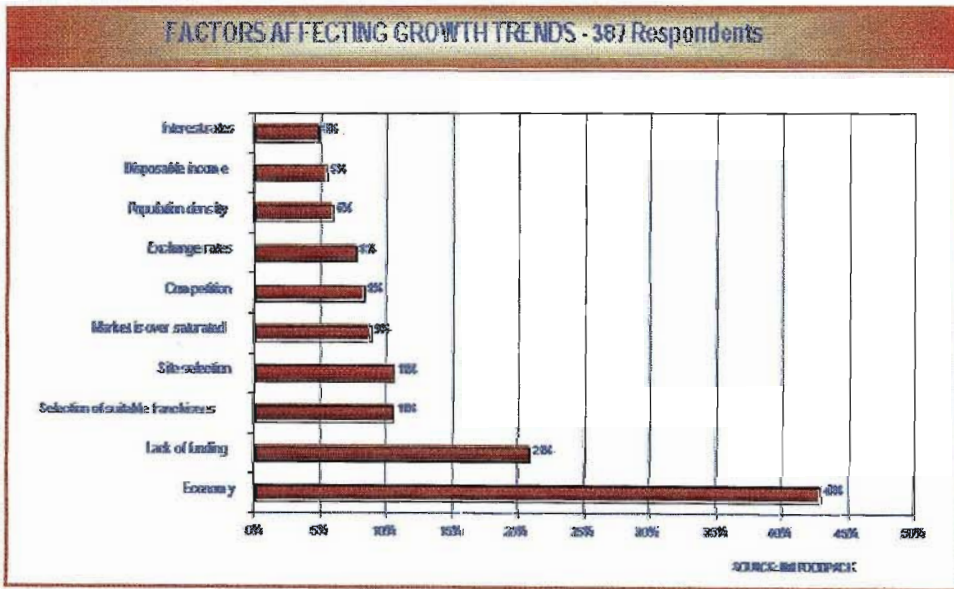


Figure 2.6: Factors Affecting Growth Trends - BMI-Foodpak Baseline Census 2002

A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

The following graph presents the 10 highest rated operational problems as indicated by respondents covering the total franchise sector.

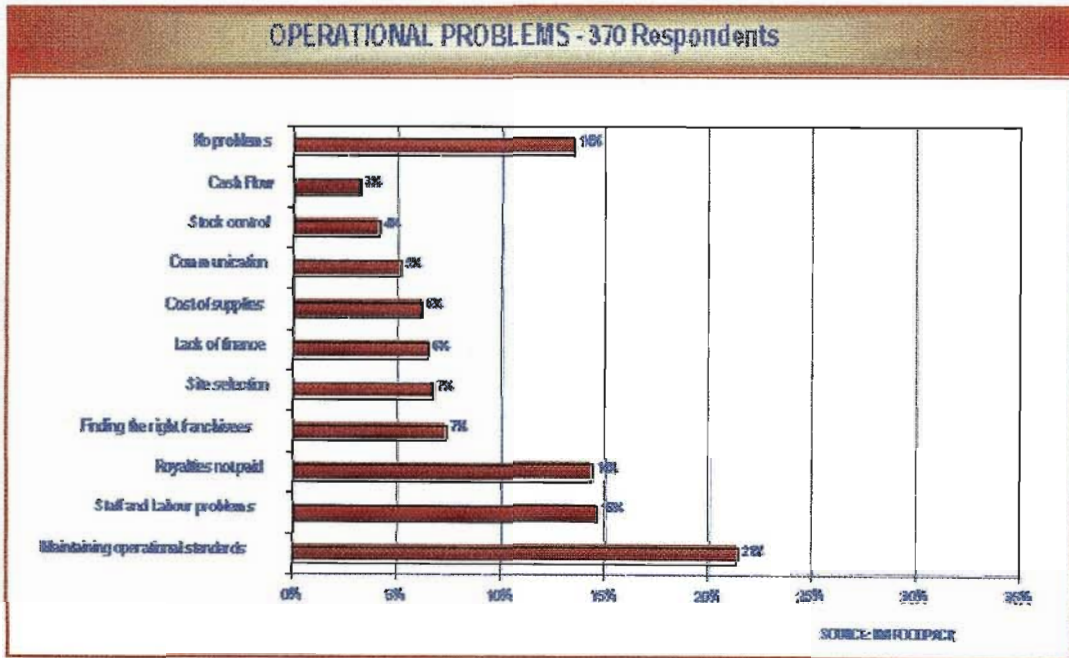


Figure 2.7: Operational Problems - BMI-Foodpak Baseline Census 2002

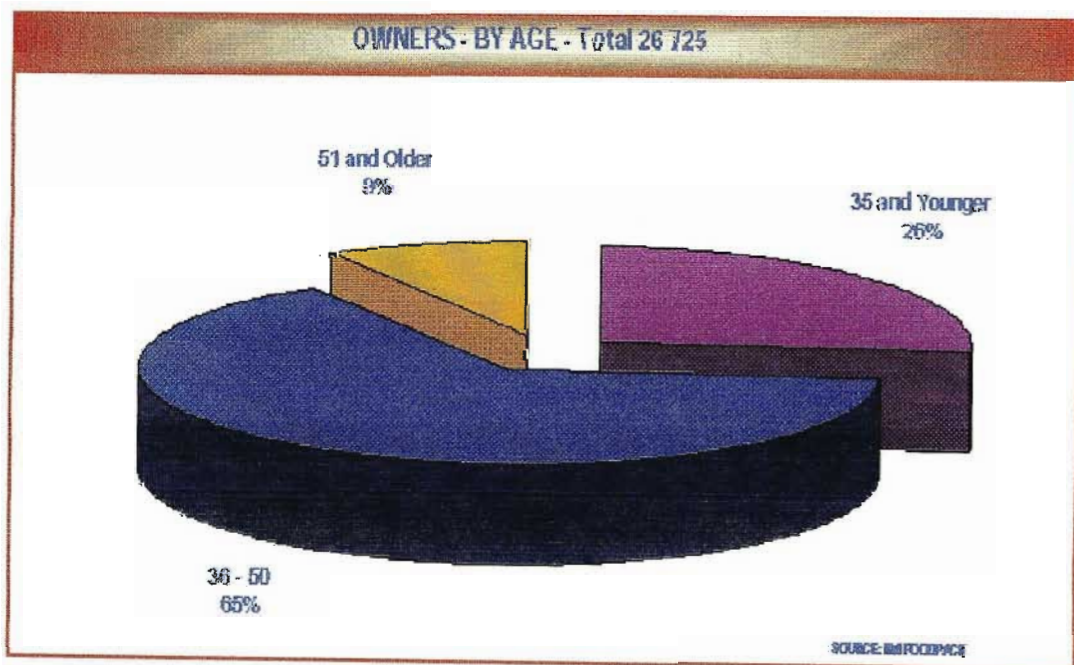


Figure 2.8: Owners by Age - BMI-Foodpak Baseline Census 2002

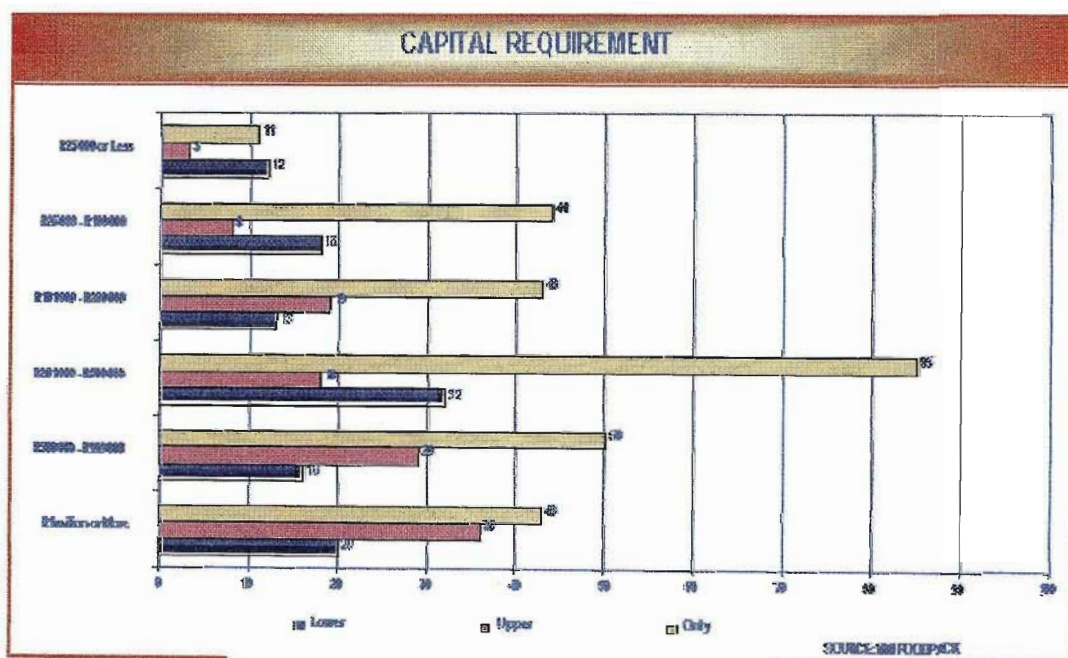
## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

Franchising would appear to appeal mainly to the 36 to 50 year old age group, which is ideally suited to the Spencer Gore franchising model as it is this age group that has the critical experience required to enhance the business model.

Average capital requirement - (Rands)				
Upper/lower limit	Fixed Capital	Working capital	Up front franchise fee	Grand Total
Only	377 689	109 502	60 808	547 999
Lower	414 460	275 479	76 917	766 856
Upper	1 206 846	1 600 726	138 111	2 945 682

**Table 2.5: Average Capital Requirements - BMI-Foodpak Baseline Census 2002**

Capital requirements vary quite considerably, but it is envisaged that the Spencer Gore model would not require as much working capital due to the proposed design as outlined in Chapter 4.



**Figure 2.9: Capital Requirement - BMI-FoodPak Baseline Census 2002**

Royalty rate calculations appear to vary between franchises as is depicted in the graph below.

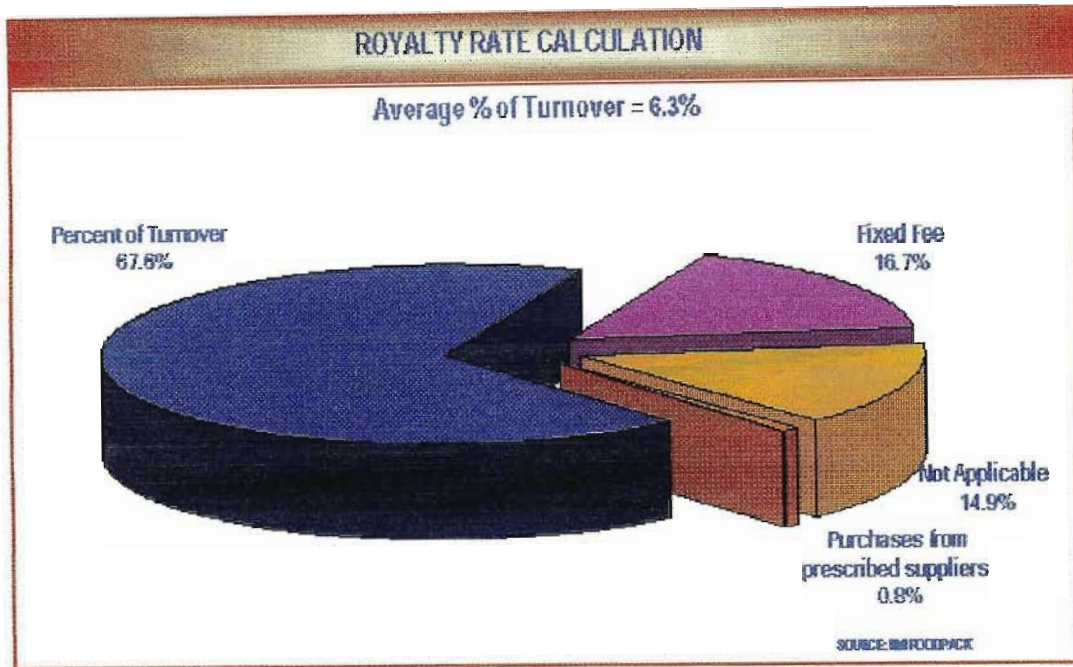


Figure 2.10: Royalty Rate Calculation - BMI-FoodPak Baseline Census 2002

### 2.3 The Entrepreneurial Flavour of Franchising

In order for franchising to retain its attractiveness it is essential that the market be directed towards entrepreneurs who are generally classified as ambitious, risk takers and flexible. According to Hisrich and Peters (1998) success in entrepreneurial ventures hinges on a clear and sustained competitive advantage combined with strong, nurtured customer relationships. The values entrenched are those of strong leadership with clear vision accompanied by clear purpose and values. Essential in resources are carefully selected and developed employees and a striving for continuous innovation.

Hisrich and Peters go on to say that one of the main problems experienced by entrepreneurs doing business on their own is that of controlling rapid growth where there is an abundance of opportunities accompanied by an abundance of capital. The entrepreneur is faced with a deluge of decisions regarding collection rates, budgets,

controls, expansion opportunities and is harassed by business delays, system interruptions and unforeseen or unplanned for surprises.

Optimal organisational culture is critical to the ongoing success of a business. The entrepreneur requires clarity of thought, the ability to set high standards, an ongoing commitment to the task at hand, and must be prepared to accept responsibility for his actions. He must also recognize and reward the input of his staff in order to maintain esprit de corps.

In order to appeal to the entrepreneurial-minded sector, franchising must identify the opportunity and expand on what makes it different. The idea must be appealing to the franchisee and be enduring as a concept. It must be timely in terms of market forces and anchored in a product or service that creates or adds value for the buyer or end user. For opportunities to have these qualities the window must be opening and be open for long enough.

In order to maintain the essence of competitiveness, entry into the market must be possible and the entrepreneur must achieve and sustain competitive advantage. Opportunities are situational. They are spawned under changing circumstances, generally out of chaos, confusion, inconsistencies, leads or lags as well as knowledge and information gaps.

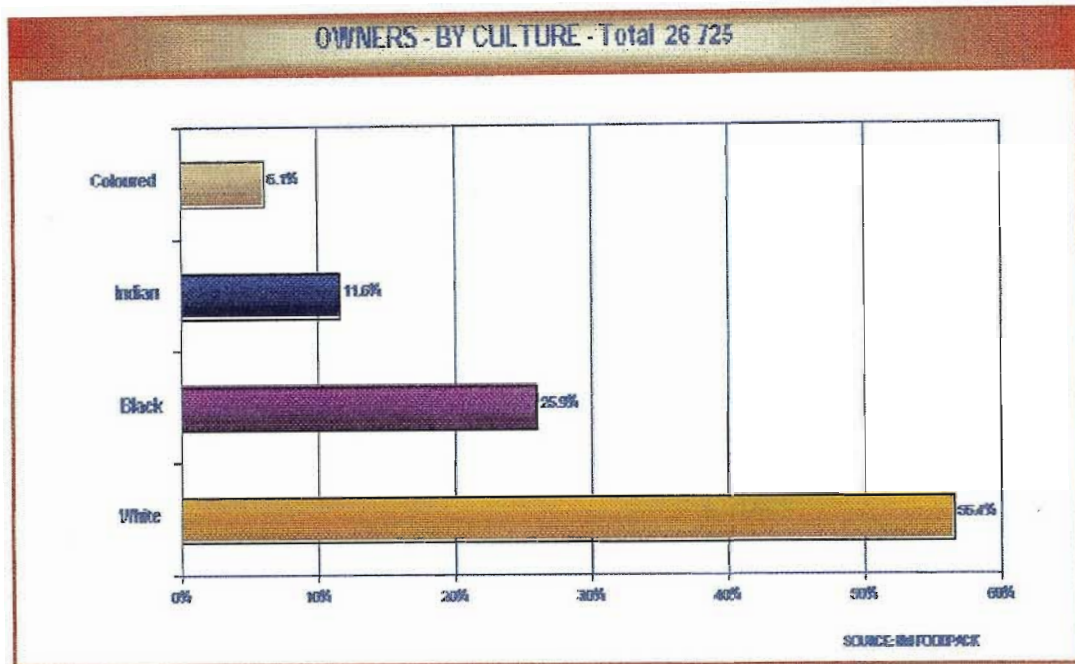
#### **2.4 Franchising as a Black Empowerment Tool**

The concept of franchising in South Africa is seen as a strong mechanism for black empowerment. Gordon (1997) states that the franchising model conforms to some constraints laid out by RDP. The thrust of affirmative action of allocating previously unavailable opportunities make franchising an ideal mechanism, as finance is readily available along with training, skills improvement and managerial supervision.

Franchising does not discriminate across race lines as can be seen in the Baseline Census of 2002 which shows a reasonable participation of blacks in franchising as illustrated in the graph below.

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## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector



**Figure 2.11: Owners by Culture - BMI-Foodpak Baseline Census 2002**

Parker Gordon Associates are of the opinion that “franchises most likely to succeed are those that provide basic commodities and services at an affordable, reasonable price” (Bisseker, 1997). The trend is therefore towards opening and operating smaller, less expensive franchises.

Van Huyssteen (1998) goes on to say that “government is recognizing the potential of the franchising industry as a source of job creation” and has therefore entered into partnerships with NAMAC, a division of the Department of Trade and Industries, and other private-sector institutions such as FASA (Franchising Association of South Africa), as well as applying pressure to banks to support and promote franchising. He goes on to say, “government therefore intends developing ‘a comprehensive strategy of support’ for the sector, including financial and non-financial support services and a new regulatory environment for franchising”

If one uses the figures provided by FASA, they estimate there are about 226 725 franchise outlets in operation within South Africa. A conservative estimates puts about 15 direct and indirect jobs in place per outlet, which equals approximately 400 875 jobs.

As recently as May 2003 the Business Partners Umsobomvu Franchise Fund was launched in order to enable and empower young South African entrepreneurs, in particular those from previously disadvantaged communities. It is a private/public joint venture between Business Partners Limited, the Umsobomvu Youth Fund and Government, with an initial investment allocation of R125million.

Aimed at young entrepreneurs with some knowledge of, and experience in business, its stated objective is to provide investment financing for viable youth-owned franchises across all sectors.

## **2.5 The Benefits of Franchising**

The basic premise of franchising is that it is considered easier to build a new business under the auspices of an established organisation, using proven methods and procedures, rather than by trial and error.

### **2.5.1 Finance**

One of the immediate benefits of franchising is the favourable view banks take when granting loans as applications are generally accompanied by a professional business plan based on a proven model. Not only is franchising finance more readily available from traditional financial institutions, but there are bodies and funds who offer facilities that cater for this sector of industry such as Business Partners Limited, the Industrial Development Corporation of South Africa Ltd and Khula Enterprise Finance Ltd among others.

# A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

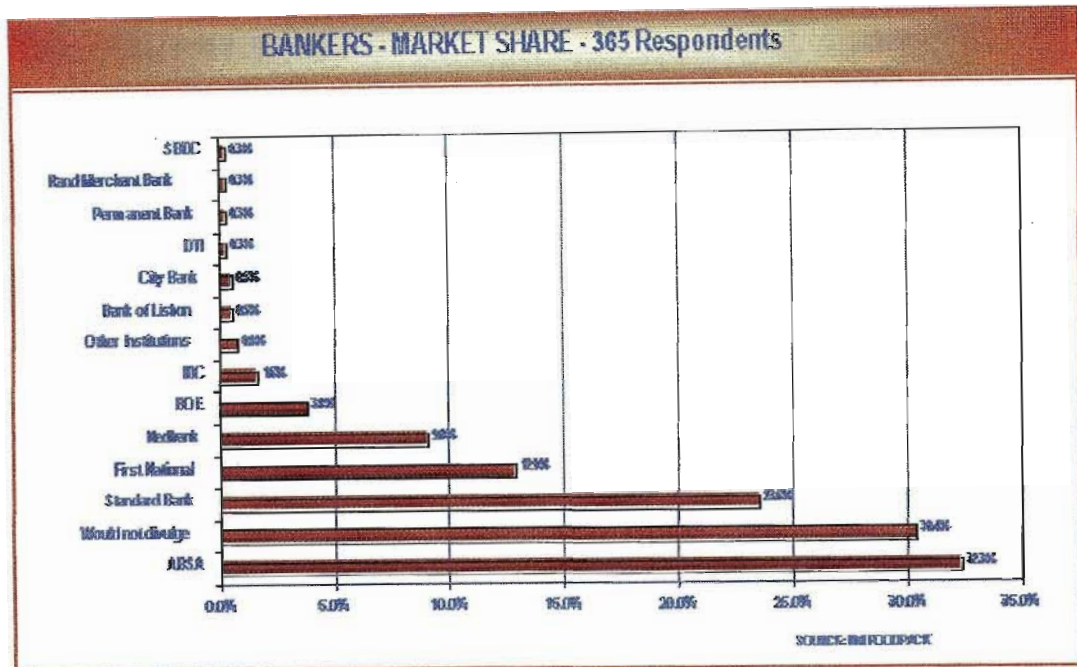


Figure 2.12: Bankers - Market Share - BMI FoodPak Baseline Census 2002

The above graph shows the participation of the various financial institutions in the franchising sector.

## 2.5.2 Training

One of the key principles of franchising is that of ongoing support and training, not only in terms of skills development in order to run the franchise efficiently as provided by the franchisor, but also in terms of Franchise Awareness Training as provided by organisations such as Franchising Plus. These programmes are designed to give general advice on franchising to potential franchisees, as well as information on the issues involved. The topics would include items such as how franchising works, how to select an opportunity, types of finances available, rules and responsibilities of franchising, etc. With a well-informed franchisee as a partner, the success rate is so much greater.

In terms of individual skills training, this is generally supplied by the franchisor. It is seen as one of the most critical areas in maintaining an ongoing and growing franchisee



market. This training, coupled with professional management advice and research and development in the particular industry ensures a blueprint for leadership in the particular franchise sector.

### **2.5.3 Group Benefits**

This is an area often ignored in the smaller, individually owned business, where the administration of benefits is often time consuming and costly. Most smaller companies are forced to rely on membership of a regulatory body in order to have access to benefits such as provident funds, medical aids, etc at reasonable rates.

Franchising offers the opportunity to provide workers with all the “big company” benefits at the reduced rates with minimal administration overheads. This will often be included in the royalty fee, thus lifting the burden from the entrepreneur, who often does not have the skills, buying power or time to negotiate better deals for his staff.

This means that in areas such as health care, pensions, insurance, etc, he can offer employees an equivalent of the prevailing corporate market, thus attracting and retaining a more satisfied, productive and motivated employee.

### **2.5.4 Advertising**

Franchise operations will generally either collect a separate turnover percentage from franchisees to be accumulated in an advertising fund or will attach a portion of royalty revenue towards advertising.

For a small independently owned business to gain market share, advertising plays an important role. However, the expenses involved with advertising are often prohibitive and the most the average small business can afford is classified advertising in regional newspapers and exposure to the public through his shop front. Another common advertising method is that of pamphlet dropping in the local neighborhood.

Because franchising offers the franchisee a reserved territory, widespread advertising enables brand recognition a lot faster, and market penetration is exponentially increased. The accumulated buying power of the franchise model ensures advertising coverage over a wider area, as well as over several media, such as radio and in instances of well established brands such as McDonalds or Kentucky Fried Chicken, even the exorbitant advertising rates of prime time television become affordable.

### **2.5.5 Purchasing Power**

This is another area where franchising offers enormous benefits. The buying power of, for example, McDonalds, changed the face of beef farming in several countries (Love, 1986). The advantages of accumulated buying power allow for reduced cost of sales, increasing the profit margin and lowering inventories and overheads. In several franchising sectors this means that not only does the franchise have the benefit of a branded quality image, but also his costing can be competitive in a sensitive market, overcoming the added expense of royalty payments that accrue in franchising.

### **2.5.6 Other Administrative Functions**

Often in a small business the sheer scope of administrative functions can be an onerous and expensive overhead. With the infrastructure of a franchise in place and assistance provided by the franchisor, matters such as Employees tax, VAT, Regional services levies, Unemployment insurance, Tax on income, etc can be easily managed and controlled.

## **2.6 Challenges of Franchising**

While the benefits of the business format franchising model are enormous, there are obviously many challenges facing both the franchisor and the franchisee.

### **2.6.1 Franchisor Challenges**

The main challenge facing the franchisor is the prospect of a low initial profit while setting up the franchise and getting franchisees on board. According to Maitland (1991), he postulates that the organisation and marketing of a proven format requires substantial

investment. Another problem arises in having to provide a guarantee that the network is established. The franchisor has to supply initial and ongoing support for a non-profit initial fee and very often the accumulation of royalties is slow and very taxing.

Added to this, South Africa is considered an undeveloped country. Alton & Welsh (2002) expand on various negative factors that may inhibit growth in countries not classified as developed, such as lack of managerial and entrepreneurial talent, lack of capital for international franchising expansion, political instability/risk and underdeveloped infrastructure. In the South African instance, while it is considered politically stable, there is a serious lack of educational infrastructure to nurture entrepreneurial talent. Access to capital is becoming more readily available in the government drive to alleviate unemployment by encouraging the SMME sector, and the identification of franchising as a viable vehicle has proved beneficial to granting of finance to proven successful business formulae.

Selection of franchisees is critical as the effort that has gone into establishing a proven quality brand may be tarnished by a poorly performing franchise. Mendelsohn (1992) expands on the theory that there is also the associated risk that the franchisor may be training a future competitor. He believes that trust must be a large component of success.

### **2.6.2 Franchisee Challenges**

Machenheimer (1998) discusses the necessity of a franchisee to be willing to put hard work, time, initiative and industry into the business otherwise it will be a failure.

Franchising is not an automatic ticket to success.

One of the greatest challenges to franchisees is working within the system. Because entrepreneurial thinking is essential in a franchisee, it is often difficult for them to restrain their natural tendency towards independence. The potential franchisee must have the ability to learn new concepts easily and must be open to change. The proven success formula of the franchise should be adhered to in order to sustain the branded image of the franchise.

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False expectations regarding the level of support expected from the franchisor can be a pitfall. Parker Gordon Associates research (Bisseker, 1997) revealed that support was generally perceived to be weak on the part of the franchisor. The franchisee must have full understanding of how the franchise operates and the franchisor should operate with total transparency regarding financial statements, projections, advertising budgets, etc.

There are extensive reporting requirements involved in franchising, as it is essential for the franchisor to keep a close watch on the activities and profitability of the franchisee. To this end it is essential that the franchisee complete all returns comprehensively and truthfully.

## **2.7 Franchising Critical Success Factors**

According to the Franchise Advice and Information Network ([www.frain.org.za](http://www.frain.org.za)) there are nine critical success factors that should be taken into consideration in order for a business model to be successfully franchised.

The first of these is whether or not the business operates in a large and growing market. It is essential that market demand should be able to sustain a franchised network, especially in the light of a successful franchise attracting competition. The opportunity should be available for both the franchisor and the franchisee to grow their respective businesses and maximize on profitability

The second aspect is whether the growth in the market is sustainable. The potential to grow is essential in order for it to be a viable proposition for the franchisee to sign a long-term contract. It is also essential, as the franchisor needs to invest considerable time and resources in establishing a solid infrastructure to support a franchised network.

Thirdly, the margins should be sufficient to cover the monthly royalty. The franchisee should be able to realize a reasonable rate of return based on financial projections regarding the economic climate and current operations. If the franchisee cannot cover the initial startup debt and royalties the viability is severely compromised.

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Fourthly, can the product or service demand a price premium? If consumers are not willing to pay a premium for the benefits offered by the franchise, such as service excellence, guarantees, etc. then the opportunity for franchising is minimized.

The fifth factor concerns access to sufficient capital. The franchisor requires capital in order to pilot the project, develop the package and build the infrastructure. Initially setting up a franchise business model is capital intensive and financial stability is imperative. In order to maintain a professional front the franchise must invest substantially in technology and professional assistance.

The sixth aspect revolves around the potential to establish a brand. In order to build a successful brand the uniqueness of the offering must be evident along with the ability to cultivate loyalty in consumers. The brand name should also be not easily replicated and should be registered in order to protect the concept.

Seventh is the barrier to entry and the ability to copy the concept. The concept should be fairly unique even if it only hinges around the benefits offered by the franchise model or the advantages gained by the consumer. The franchise should be able to differentiate itself from competitors in order to be sustainable.

The eighth factor is that the development costs should give a satisfactory return on investment. Both the franchisor and franchisee will incur capital costs in developing the project and the return on investment must be such that it makes good business sense to continue developing the franchise network.

Last is developing a franchise culture that should be open and learning oriented, flexible and supportive. The franchisor and franchisee are interdependent for success and both should have a long-term vision and commitment to the franchise network.

## **2.8 Conclusion**

Franchising has rapidly established itself as a viable medium for the growth of a business model in South Africa. The number of successful franchises in the country bear testament to the success of the medium and the low failure rate of franchises has enhanced the attractiveness of the franchise business model.

Along with this, the government focus on franchising as an opportunity to empower previously disadvantaged individuals coupled with the ability of franchising to improve employment levels in the country makes it an extremely attractive sector to enter. One of the major advantages of entering the market as a franchisor is that government does not require Black equity in the franchisor model, but is willing and able to assist in empowering potential franchisees to partake in the model.

The challenges of franchising on the part of both the franchisor and the franchisee are numerous but far outweighed by the benefits. It is essential that both the franchisor and the franchisee enter the relationship with the same level of commitment to the brand and the same vision to grow the business.

It is essential that the franchisor maintain continuous commitment to product development, market research, initiation of joint purchasing programmes, training and quality control.

Franchisees should retain responsibility for brand building and local service excellence. Consumers have learned to expect a certain level of quality and service from brands that is endorsed in the advertising message and promotions, and it is critical that these standards are maintained.

There are several critical success factors that should not be ignored. It is in the attention to detail when setting up a franchise that builds the foundation for continued success.

## **CHAPTER 3: CASE STUDY OF THE COMPANY AND THE BUILDING INDUSTRY WITHIN WHICH IT OPERATES**

### **3.1 Introduction**

The building industry in South Africa is currently going through an unprecedented growth phase. Property has long been seen as a lasting investment offering excellent returns, but in the last few years the escalation of property values has exceeded all expectations.

With the value of property rising rapidly, the affordability of purchasing property in prime areas has become out of reach for many consumers. Existing homeowners are renovating property in order to maximize their investment and new purchasers are looking for bargains with potential to upgrade and improve the value of the residence. The potential in this market is huge and growing all the time.

### **3.2 Regulatory Bodies in the Building Industry**

The primary regulatory body of the formal building sector is the Master Builders Association, which falls under the Building Industry Federation of South Africa (BIFSA). BIFSA functions as a federation of Master Builder Associations (MBAs). The Federation was formed in 1904 and represents the national interests of employers in the building and allied industries and serves in a co-coordinating role. It is the mouthpiece of the formal industry in all matters of national consequence. Their primary aim is to provide leadership to the Building Industry by directing and co-coordinating activities, providing quality service, maintaining a national platform and promoting a profitable environment to achieve benefits for its members and the community. This involves liaison with the professions, government departments and other public bodies, the public and kindred employer groups. Their activities include labour relations, accident prevention, tendering and contracts, legal matters, lobbying and monitoring development of new methods and techniques. ([www.bifsa.org.za](http://www.bifsa.org.za)).

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## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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Founded in 1901, the KwaZulu-Natal Master Builders Association is the leading construction employers' association in the province of KwaZulu Natal and provides benefits to both its members and the general public alike. Their mission is stated as “to contribute towards the economic well-being of our members by means of excellence of services in an innovative and effective manner” ([www.mba-kzn.co.za](http://www.mba-kzn.co.za)).

The MBA provides its members with several benefits, chief among which is credibility with potential customers. They funnel advice and information through to their members by means of Newsletters and various publications offered on their website. Included in their services is a weekly Tender Bulletin containing details of government, provincial, local authority and private tenders.

The MBA also provides members with an Employee Benefit Scheme which encompasses Holiday Pay Provisions, Provident and Pension Funds and Insured Benefits Fund, etc all at cost-effective rates.

In a personal interview with Roger Pickles, the Membership Services Manager of the KwaZulu Natal MBA, he revealed that they currently have approximately 400 members. He went on to say that the MBA was the only regulatory body available to operators in the Building sector, and as membership was voluntary it was essential for the public to avail themselves of the advice and availability of registered builders before commencing building work. Essentially, the phrase “*caveat emptor*” applies in its most real form.

The MBA deals with complaints from both builders regarding clients and clients regarding builders; an interesting aside is the fact that most of the complaints stem from builders not getting payment from clients rather than unhappy clients.

When asked what he perceived to be the biggest problems in the small to medium building sector, he felt that the lack of experience in the younger builders was a stumbling block. These builders emerge straight out of Technicon and set up their own operations. All they have is theory and are lacking in training and practical knowledge.

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## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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He went on to list the pressures of the highly competitive environment along with poor training of the workforce and poor wages as a demotivating factor.

In particular he referred to the prevalent practice of building companies hiring “sub-contractors” to work projects. This meant that these men had no recourse to any benefits whatsoever and no job security, relying on being hired on a job-to-job basis.

He also cited customer ignorance as a very important factor in the contractor selection. One of the main problems lies in the fact that most customers will only do alterations or additions once or maybe twice in their lifetime. They have no foundation on which to base the experience and rely heavily on family and friends who may have previous experience in this area. Often they use the same methodology as a housewife doing her monthly grocery shopping – shopping around for best prices or “specials”, not equating the enormous amount of money, inconvenience and expertise that goes into the building process. To this end the MBA has actually produced a booklet entitled “How to get the best from your Building Contractor” in order to aid consumer education in this sector.

When asked what steps he felt should be taken to improve standards in the industry in general he propounded a theory of a board similar to the old Industrial Development Board that was phased out in 1994. This board would regulate activities and hold a watching brief over the contractors, in order to promote good practice. There is a proposal currently being considered at government level to compel building contractors to be registered and to hold a minimum formal qualification (as yet to be decided) in order to practice.

The other issue he felt was to take steps to promote a better image for people participating in the trades. The current perception is that “you do not have to be clever to be a builder”, which means that there is often a stigma attached to people operating in this sector. There is also a severe shortage of skilled foremen. This has come about due to the previous practice of job reservation where foremen were white and the labourers were black. The traditional training method for labour was to apply skills to one area

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only, for example, bricklaying or plastering or painting, etc. This meant that when the labour forces shifted with the new government in place, there were very few black people in the industry that were multi-skilled. The practice of sub-contracting has exacerbated the problem with disparate teams of workmen on site each with their own skill set, and no one with the overall necessary skills to oversee all the various sub-contractors. Most foremen come through to the industry having done a technical construction supervisor course at a Technicon and then acquire practical experience within a larger organisation. The problem is that they then go on their own as a building contractor, often in the informal sector, and their expertise is lost to the formal building sector.

Methods of working around these problems seem to come mainly from research and design into simpler structures. With the basic commercial building now consisting of a reinforced concrete frame, all that is necessary to erect an office block, for example, is a team of shutter hands and concrete gangs. This solution is well and good in the commercial sector, but the residential sector requires individualization and specific design. In the RA&A market in particular, where often the houses to be renovated are older, the contractor must have a good knowledge of building construction in order to maintain the existing standard of the building and conform to the original design.

### **3.3 Market Analysis**

#### **3.3.1 The Current Market**

The most recent statistical survey information was obtained from Statistics SA, Selected Building Statistics of the Private Sector derived from Data Reported by Local Government Institutions, November 2002. According to this survey, the value of building plans passed for the month ended November 2002, were as follows (please note the following descriptors: Other residential buildings include institutions for the disabled, boarding houses, old people's homes, hostels, hotels, motels, guest houses, holiday chalets, entertainment centers, bed-and-breakfast accommodation and casinos;

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A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

Other buildings include additions and alterations to other residential buildings, non-residential buildings and internal alterations):

Actual estimates at constant 2002 prices	November 2002	January 2002 to November 2002	Percentage change between November 2001 and November 2002	Percentage change between September 2001 to November 2001 and September 2002 to November 2002	Percentage change between January 2001 to November 2001 and January 2002 to November 2002
	Rmillion	Rmillion	Rmillion	Rmillion	Rmillion
Residential buildings:					
Dwelling houses	713.3	7835.8	+ 14.6	+16.2	+10.9
Flats and townhouses	213.7	2152.7	-19.8	+9.2	+17.3
Other residential buildings	1.7	231.6	-78.7	-84.3	-49.0
<b>Total</b>	<b>928.7</b>	<b>10220.1</b>	<b>+3.6</b>	<b>+5.0</b>	<b>+9.2</b>
Additions and Alterations	541.9	5548.4	-1.1	+6.3	+14.6

**Table 3.1: Building Plans Passed for Month Ended November 2002 - Statistics SA**

This table clearly shows the high value of the Additions and Alterations market compared to the value of the residential market as a whole. The increase of 14.6% in the year on year figures shows an ongoing growth trend in the sector of the building industry.

The provincial contribution of KwaZulu Natal to the value of building plans passed is as follows:

Percentage contribution to the total real value of plans passed during January 2001 to November 2001	12.2
Percentage change between January 2001 to November 2001 and January 2002 to November 2002	+19.5
Contribution (percentage points) to the percentage change in the real value of plans passed between January 2001 to November 2001 and January 2001 to November 2002	+2.4
Difference in total real value of plans passed between January 2001 to November 2001 and January 2002 to November 2002 – Rmillion	+412.3

**Table 3.2: Contribution of KwaZulu Natal to Total Real Value of Building Plans Passed - Statistics SA**

A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

This table clearly shows the strength of the building industry in Kwa-Zulu Natal. The detailed breakdown of the KwaZulu Natal residential sector figures follows:

Type of Building	November 2001	October 2002	November 2002	January 2001 to November 2001	January 2002 to November 2002	Percentage change between January 2001 to November 2001 and January 2002 to November 2002
<b>Residential Buildings:</b>						
<b>Dwelling houses smaller than 80 square metres</b>						
Number of dwelling houses	160	193	147	2247	2183	-2.8
Total square metres	7250	8503	6811	97651	90277	-7.6
Total value at current prices (R'000)	8688	8583	7420	96764	88575	-8.5
<b>Dwelling houses equal to or larger than 80 square metres</b>						
Number of dwelling houses	155	238	174	1572	1794	+14.1
Total square metres	30812	55990	38866	333533	407736	+22.2
Total value at current prices (R'000)	44380	94104	71648	488699	655797	+34.2
<b>Flats and townhouses</b>						
Number of flats and townhouses	50	216	107	838	1018	+21.5
Total square metres	9929	33706	23080	116008	175213	+51.0
Total value at current prices (R'000)	20524	64741	40907	195215	310191	+58.9
<b>Other residential buildings</b>						
Total square metres	0	44	226	20202	32440	+60.6
Total value at current prices (R'000)	0	44	285	82431	34764	-57.8
<b>Total value of residential buildings at current prices (R'000)</b>	<b>73592</b>	<b>167472</b>	<b>120260</b>	<b>863109</b>	<b>1089327</b>	<b>+26.2</b>
<b>Additions and Alterations</b>						
<b>Dwelling houses</b>						
Total square metres	36047	49670	47328	371558	427349	+15.0
Total value at current prices (R'000)	42581	68490	64071	454058	561759	+23.7
<b>Other buildings</b>						
Total square metres	13878	20881	10670	163905	214065	+30.6
Total value at current prices (R'000)	30472	40630	22468	329774	583464	+76.9
<b>Total value of additions and alterations at current prices (R'000)</b>	<b>73053</b>	<b>109120</b>	<b>86539</b>	<b>783832</b>	<b>1145223</b>	<b>+46.1</b>

**Table 3.3: Building Plans Passed According to Type of Building in KwaZulu Natal**

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

The table clearly shows that in KwaZulu Natal the value of the alterations and additions market exceeds that of the new residential building market and is showing almost double the growth from the previous period.

### 3.3.2 The Local (Durban) Market

The Statistics SA survey broke the building plans passed figures down from country to province and then to major cities. The figures for Durban were as follows:

Type of Building	November 2001	October 2002	November 2002	January 2001 to November 2001	January 2002 to November 2002	Percentage change between January 2001 to November 2001 and January 2002 to November 2002
<b>Residential Buildings:</b>						
<b>Dwelling houses smaller than 80 square metres</b>						
Number of dwelling houses	19	50	52	733	715	-2.5
Total square metres	1382	2605	2940	38595	36295	-6.0
Total value at current prices (R'000)	1426	2956	3442	45129	42014	-6.9
<b>Dwelling houses equal to or larger than 80 square metres</b>						
Number of dwelling houses	114	78	64	949	755	-20.4
Total square metres	18798	16677	12174	185932	139050	-25.2
Total value at current prices (R'000)	21958	20794	16138	223228	177199	-20.6
<b>Flats and townhouses</b>						
Number of flats and townhouses	21	4	31	507	237	-53.3
Total square metres	3272	1557	4614	50828	33539	-34.0
Total value at current prices (R'000)	6120	1883	6581	68474	51985	-24.1
<b>Other residential buildings</b>						
Total square metres	0	1246	0	0	1246	..
Total value at current prices (R'000)	0	1263	0	0	1263	..
<b>Total value of residential buildings at current prices (R'000)</b>	<b>29504</b>	<b>26896</b>	<b>26161</b>	<b>336831</b>	<b>272461</b>	<b>-19.1</b>

A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

Type of Building	November 2001	October 2002	November 2002	January 2001 to November 2001	January 2002 to November 2002	Percentage change between January 2001 to November 2001 and January 2002 to November 2002
<b>Additions and Alterations</b>						
<b>Dwelling houses</b>						
Total square metres	23335	32981	15536	271003	233371	-13.9
Total value at current prices (R'000)	25593	40135	19428	298733	278898	-6.6
<b>Other buildings</b>						
Total square metres	6260	1869	5957	85641	66031	-22.9
Total value at current prices (R'000)	10407	9978	20141	160843	149735	-6.9
<b>Total value of additions and alterations at current prices (R'000)</b>	<b>36000</b>	<b>50113</b>	<b>39569</b>	<b>459576</b>	<b>428633</b>	<b>-6.7</b>

**Table 3.4: Buildings Completed According to Type of Building: Durban - Statistics SA**

This table shows a downward trend in the Durban area which taken on its own may give rise to concern but looking at the overall expenditure in the area it becomes evident that there is still an enormous amount of money being spent, with the 2002 figure being some R280million. This figure itself is extremely conservative as calculations reveal that the average cost per square metre is some R1 200.00. This is a completely unrealistic figure as even medium cost housing averages out at R1 800.00 to R2 000.00 per square metre and the costs escalate to as much as R5 000.00 to even R7 000.00 per square metre in the more exclusive northern suburbs.

In order to validate these assumptions further research was undertaken in the northern Durban RA&A market with initial forays to the North Local Council's Building Planning offices in order to ascertain the value of the market in the greater Umhlanga Rocks area

A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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Area	Type of Work	Value (000's)
Glenashley	Alterations/Additions	R 3,663
La Lucia	Alterations/Additions	R 25,532
Mount Edgecombe	Alterations/Additions	R 7,089
Umhlotdi	Alterations/Additions	R 2,674
Umhlanga Rocks	Alterations/Additions	R 13,417
<b>Total:</b>		<b>R 52,375</b>

**Table 3.5: Value of Alterations/Additions Courtesy of Figures Supplied by North Local Council**

The above figures refer to the period 1<sup>st</sup> August 2002 to 31<sup>st</sup> May 2003. Again these figures are conservatively estimated as, according to the planning office of the North Local Council, they ascribe a value of R2,000 per square metre, regardless of the area. A further complication arose due to the fact that North Local Council does not computerize their records and very kindly photocopied their handwritten log sheets. These sheets were often vague in the description and it is possible that many projects were incorrectly allocated. The researcher erred on the side of caution in several instances and it is most likely that the figures are understated rather than inflated.

This area in particular would carry a value of at the least R4,000 a square metre, and the figure could therefore comfortably be doubled in order to gauge a more accurate estimation. We can thus assume a minimum value of R100million in the north of Durban area alone for the RA&A market, making this a very lucrative target market indeed, bearing in mind that new homes and commercial buildings have been excluded entirely from the calculations.

### **3.4 Competitor Analysis**

#### **3.4.1 The Small to Medium Building Contractor**

This sector of the building industry can be clearly differentiated between the formal sector and the informal sector. The formal sector is generally a member of a regulatory body such as the Master Builders Association and is VAT registered. The informal sector seldom registers with any regulatory body and is not VAT registered.

#### **3.4.2 The Informal Building Sector**

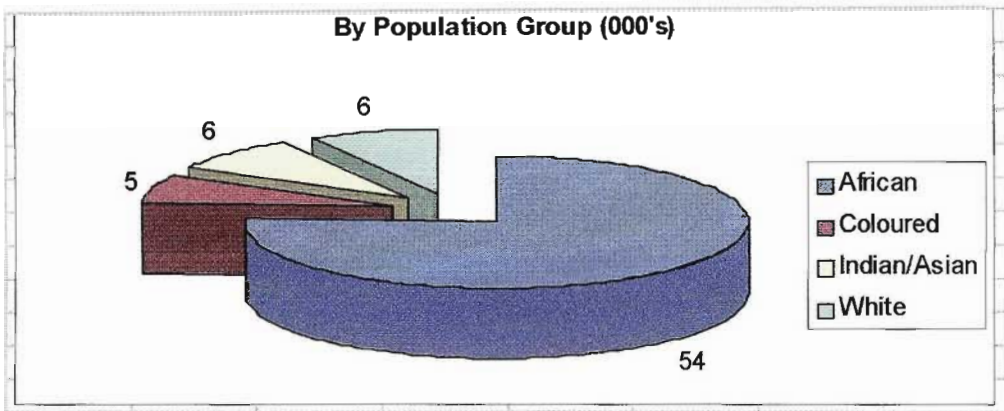
Barriers to entry into this sector of the market are relatively low as there is a low capital requirement. Many of the operators run small-scale operations, relying on family ownership/participation, utilizing skills acquired outside the formal education system. According to Roberts (1997) almost 40% of men in the informal sector work as artisans or craftsmen such as building, house painting or carpentry.

Statistics in this sector are extremely difficult to come by. The only reference available was a recent study done by Statistics SA entitled "The contribution of small and micro enterprises to the economy of the country: A survey of non-VAT-registered businesses in South Africa (2002). The building industry statistics have been extrapolated from this report in order to establish the scope of this sector and the influence on the Small to Medium Building sector as a whole.

The population distribution of persons participating in this sector (which is estimated at about 71 000) is shown in the graph below:



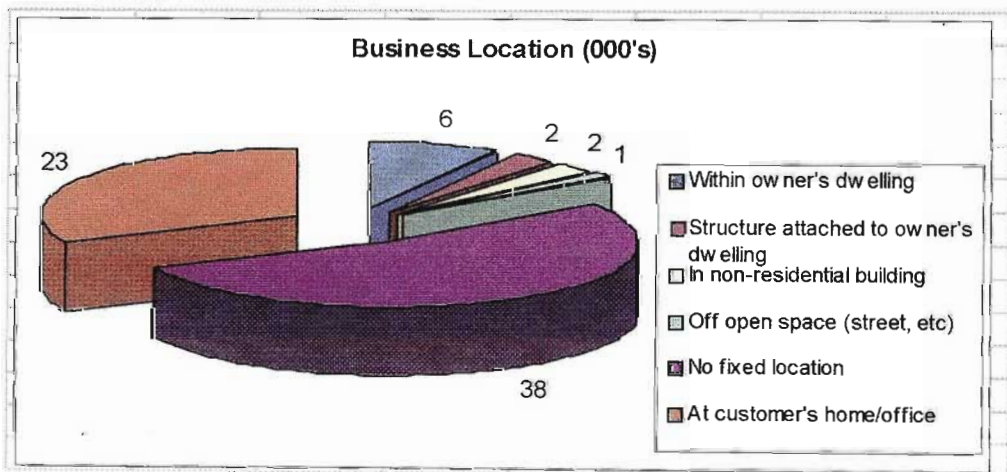
A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector



**Figure 3.1: Population Distribution of Persons Participating in the non-VAT-Registered Building Sector**

It is clear from these statistics that the vast majority of non-VAT-registered operators fall within the previously disadvantaged population group. Without the historical benefit of access to capital and education, these operators now have the opportunity to legitimize and expand their operation.

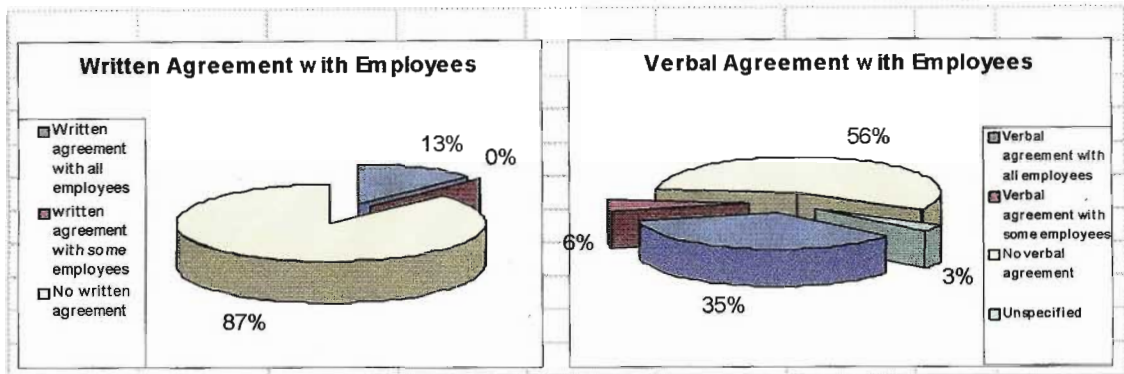
Of these 71 000 participants, the report lists the business location as follows:



**Figure 3.2: Business Location of Operators in the non-VAT-Registered Building Sector**

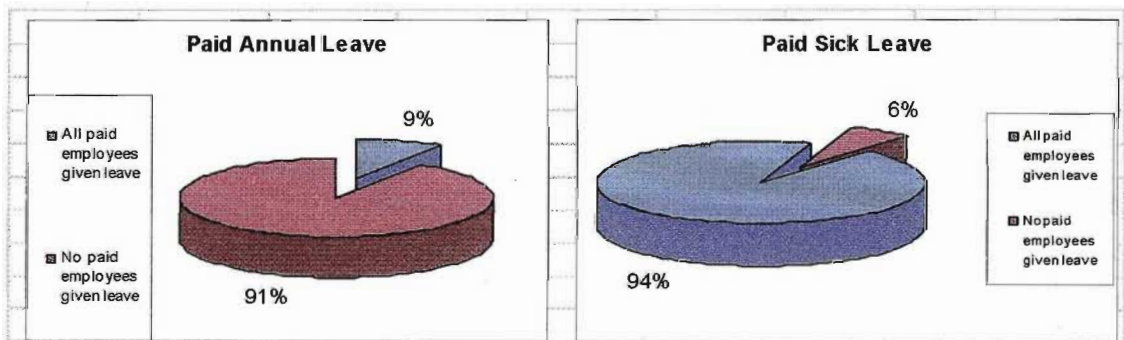
## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

The number of these businesses employing people with an agreement or contract is depicted as follows:



**Figure 3.3: Employees in the non-VAT-Registered Building Sector With Either Written or Verbal Agreements**

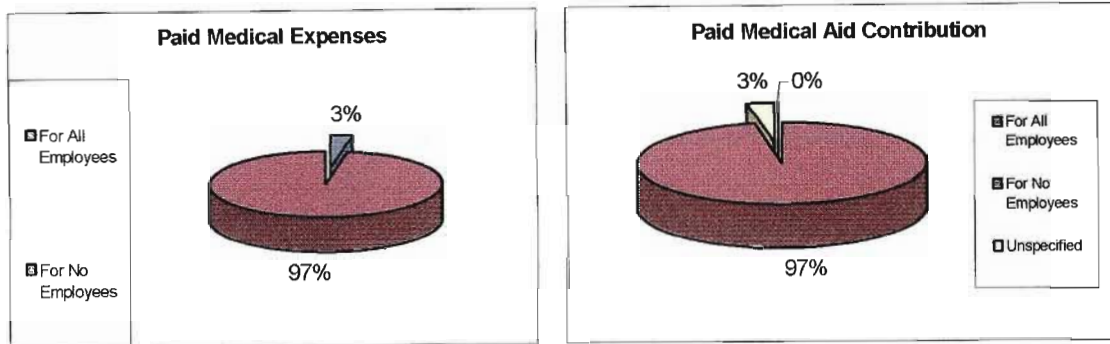
It may be inferred from these figures that there is very little job security or legislated administration being done in this sector. In support of this, the following graph depicts the number of employees that are given either paid annual leave or paid sick leave.



**Figure 3.4: Employees in the non-VAT-Registered Building Sector with Paid Annual or Sick Leave**

A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

With regard to employee benefits, the following graphs show the number of business that offer employees paid medical expenses or offer contributions to medical aid payments.



**Figure 3.5: Employees in the non-VAT-Registered Building Sector With Either Paid Medical Expenses or Medical Aid Contributions**

The report then queried whether the business owners saw the necessity for training in various skills, and the response was as follows:

Technical Skills	39%
Marketing Skills	18%
Commercial/Bookkeeping/Financial Skills	6%
Managerial Skills	9%
Literacy Skills	18%
Numeracy	12%

**Table 3.6: Necessity for Training in Various Skills in the non-VAT-registered Building Sector**

While initially these figures may appear confusing, it must be borne in mind that the bulk of the workforce in this sector are labourers. The job requirements are not those of commercial or marketing skills, however, the need for technical skills development is recognized, along with the benefit of literacy and numeracy skills in this labour market.

The question of whether or not the entrepreneur required money to start the business met with a positive response rate of 49%, however only 6% of these managed to borrow money in order to start their business.

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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The research showed that in the month previous to the research being conducted, the Gross Income earned in this sector was R185.381million.

The above figures reveal an industry that is enormously unregulated with constant infractions of labour laws. The nature of the industry does not allow for unionization as the workforce is constantly moving from one building site to another. There is also a large amount of money being spent in this sector and the potential for absorbing some of these operators into a franchise operation seems promising, with the lure of increased income, reduced overheads and reduced administration, with the aura of respectability attached that would enable these operators to raise the necessary finance in order to expand their individual operations.

### **3.4.3 The Formal Building Sector**

The formal sector may be defined by those operators running a registered business with regular fixed premises and certain fixed costs such as rent, licence fees, etc. Most of these businesses operate under independent ownership and are owner managed with a simple organisational structure often comprising no more than the owner/manager, perhaps a foreman, and often the owner's wife doubling as secretary/receptionist. Individually they have a relatively small influence on the market, with a turnover of under R5million per annum and employing less than 100 people, with assets of less than R1,5million (Ramsdale, 1990).

Information regarding this sector was even more difficult to come by, and reliance was placed on empirical research done by means of a short questionnaire (see Appendix D for sample questionnaire) faxed to some twenty local building construction companies, all members of the MBA who utilize the membership benefit of client referrals.

A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

In brief the questions and responses garnered are summarised as follows:

<b>Is your company registered as</b>	<b>CC</b>	<b>(Pty) Limited</b>	<b>Other</b>		
	6	1			
<b>Are you VAT registered?</b>	<b>Yes</b>	<b>No</b>			
	7	0			
<b>Are you registered with NHBRC</b>	6	1			
<b>If yes, approximate value of new houses built in last 12 months</b>	<b>0</b>	<b>R1 – R500 000</b>	<b>R500 000 – R1million</b>	<b>Over R1million</b>	
	4		1	2	
<b>Average turnover in RA&amp;A</b>	<b>Under R100 000</b>	<b>R100 000 – R250 000</b>	<b>R250 000 – R500 000</b>	<b>R500 000 – R1million</b>	<b>R1m – R2m</b>
		1		3	3
<b>Do you have an office separate from your home?</b>	<b>Yes</b>	<b>No</b>			
	4	3			
<b>Do you employ a full time secretary</b>	4	3			
<b>What office equipment do you have</b>	<b>Photocopier</b>	<b>Mother than one phone line</b>	<b>Computer</b>	<b>e-mail</b>	
	4/7	5/7	6/7	4/7	
<b>Is your main business telephone contact via cell phone</b>	<b>Yes</b>	<b>No</b>			
	6	1			
<b>How many work vehicles do you have (bakkies/trucks)</b>	<b>0</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>More than 3</b>
			2	1	4
<b>Do you employ a fulltime foreman</b>	<b>Yes</b>	<b>No</b>			
	6	1			

A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

How many years has your company been in business for	0-3 yrs	4-7 yrs	8-10 yrs	Over 10 yrs	
		1	3	3	
Do you believe you have the capacity to expand your operation if you could get more business	Yes	No			
	6	1			
What do you think is the biggest obstacle to expanding your business?	1 cited Retirement 1 cited affirmative action 3 cited lack of capital 1 cited slow growth in residential market 1 cited shortage of skilled foremen				

**Table 3.7: Responses Elicited From Formal Sector Builders**

While the study of local builders in the formal sector cannot be considered comprehensive, it gives a strong indication of the infrastructure and overheads involved. The majority of respondents showed high administrative costs such as maintaining a separate office, employing a full time secretary, equipping the premises and employing a full time foreman.

All respondents answered positively to having more than one telephone line but this may be due to the ambiguity of the question where it was not definitely stated whether the second line was a cellular telephone or a fixed landline. In either event, the telephone costs are high.

Most respondents answered positively to doing most of their business via cell phone, which indicates that they spend little time in the office.

While all bar one respondent were members of NHBRC only three responded positively to having built new houses in the previous year, and from the revenues shown as between R1million and R2million this would indicate a probable maximum of 2 houses apiece.

This indicates a desire to be involved in this market but due to the current domination of Moreland Property Group developments and new developments in the Ballito area, high capital reserves are required to enter the market.

With the exception of one respondent who was due for retirement, the general consensus appeared to be positive regarding the future of the RA&A sector, concerns regarding their individual ability to expand their business stemmed from matters such as lack of finance, affirmative action, slow growth in market and a shortage of skilled foremen.

### **3.5 Spencer Gore Construction**

In terms of strategic forward thinking it is appropriate to take cognizance of the words of Brand Pretorius (1993) who is quoted as saying “winners in the business world are those that move faster than their environment”. This is especially true in the building industry where competition is fierce and competitive advantage is seldom sustainable in the long-term.

#### **3.5.1 Key Success Factors**

Spencer Gore Construction has several advantages in the building industry sector. In order to analyse these in context, the factors have been split into six sections, namely Technology, Manufacturing, Marketing, Skills, Organisational Capability and Other.

##### **3.5.1.1 Technology**

By virtue of the fact that the company currently employs two MBA graduates and one final year student it is self-evident that expertise exists in the financial and research fields, as well as a comprehensive understanding of current information technology and trends. This allows the company to maintain a leading edge on innovation and production improvements.

The company already has an Internet presence and plans are underway to increase this presence in order to keep clients up to date with work in progress on their particular projects as well as posting digital progress photographs to individual secured web pages.

### **3.5.1.2 Manufacturing**

While manufacturing in the commonly accepted sense does not apply, if one deems the erection of a wall, the plastering of the wall and the painting of the wall to be essentially the manufacturing of a house, then the phraseology applies. Because Spencer Gore Construction uses project management tools, managing and moving labour between sites and scheduling jobs in order to maximize labour utilization are simplified. This leads to fewer inefficiencies and downtime.

Maintaining a close watching brief on all work in progress by means of Project Managers who oversee approximately three or four discrete projects as well as a full-time foreman responsible for technical aspects on site, any work defects are quickly spotted and corrected. The focus of Spencer Gore on quality as it is believed that in the long term this particular attribute is most valued and leads to the most referrals.

The company has a well-designed infrastructure with offices equipped with computers, Internet access, fax machines, photocopiers etc. Also available is a warehouse where all material is stored allowing the company to buy in and store materials until required – very often on short notice.

The labour force has remained unchanged for the last ten years, the policy of production bonuses and Christmas shutdown with bonuses ensuring a loyal and productive workforce.

The focus of the company is to maintain total customer satisfaction and while the house is in production all changes required by the owner are taken into consideration and costed before production, ensuring the client does not face a potentially large and unbudgeted increase in final building costs.



### **3.5.1.3 Marketing**

At Spencer Gore the customer has access to project managers seven days a week, twenty-four hours a day via cell phone. The customer is the driving force in the company – it is considered absolutely non-negotiable that any and all requests, no matter how unreasonable, are given consideration.

All alteration and additions undertaken by the company are given an unconditional guarantee. The company will often undertake additional work not covered in the schedule of finishes on an ex-gratia basis to maintain not just good, but excellent customer relations.

In order to maintain a professional edge, all quotations are accompanied by a high quality brochure, along with a company mouse pad, all presented in a specifically designed folder. The company prides itself in turning a quote request around in under seven days.

### **3.5.1.4 Skills**

As mentioned previously, the academic qualifications of the management of Spencer Gore are impeccable. Quality control is ongoing and is stressed daily on every site. Combined with technological expertise, financial expertise and marketing expertise, this is considered one of the company key success factors.

In addition, workforce skills are essential to ensure high standards on site. New specialist labour must be sent on skills training courses, usually two to four weeks long, in order to enhance their brick laying or plastering skills.

### **3.5.1.5 Organisational Capability**

With high-speed modem access and Internet connectivity on every desk, all management has access to superior information systems. By maintaining a close watch on the shifting property market, subscribing to leading daily and weekly newspapers and journals, as well as maintaining membership with both the MBA and NHBRC, the company ensures a quick response to market shifts, targeting various areas of growth as they appear.

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### **3.5.1.6 Other**

Spencer Gore Construction enjoys a very favourable image and reputation, which has taken several years to acquire. This is evinced by the number of referrals the company receives from satisfied clients, as well as maintaining close bonds with all previous and existing clients.

A critical factor in the building industry is maintaining overall low costs. This is done by means of Just in Time ordering and stringent on-site material controls to prevent pilferage and overages. The scope of operations of the company is restricted to convenient locations in terms of control and travel time, operations commencing in Musgrave and going up as far as Ballito. This has been identified as the most profitable sector to operate in, in terms of value of projects, as the company is reluctant to take on projects under R100 000 with a value of under R4000 per square metre.

All site workers are provided with Spencer Gore overalls and hard hats when necessary. The company takes great pains to maintain a pleasant and cheerful workforce, minimizing inconvenience to house owners.

A perennial problem in the small to medium construction sector is access to capital. It is the Catch 22 situation where capital is needed to finance developments and break out of the market, but without a track record, affordable financing is impossible to attain. Fortunately, however, Spencer Gore is slowly accumulating working capital, and in the near future, it is envisaged that sufficient funding will be available to make strategic growth moves possible.

## **3.5.2 SWOT Analysis**

### **3.5.2.1 Strength/Capability**

- powerful strategy
  - support of skills/ expertise
  - strong financial resources
-

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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- strong brand name/ image/ reputation
- recognised market leader / strong customer base
- economies of scale / experience curve
- superior intellectual capital
- cost advantages
- strong advertising/ promotion
- product innovation
- skills to improve production processes
- e-commerce tech & processes
- supply chain management
- good customer service
- better product quality
- alliances/ joint ventures

### **3.5.2.2 Weakness/Deficiency**

- no clear strategic direction
- too narrow a product line
- Small management team
- Lack of capital
- Lack of exposure
- Small trained/skilled workforce
- No black empowerment partner

### **3.5.2.3 Opportunity**

- additional customer groups
  - new geographical areas
  - utilise existing skills/know-how to enter new business
  - use internet/e-commerce for new sales growth
  - openings to grab market share
  - ability to grow due to rising demand
-

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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- acquisition of firms with tech expertise
- alliance/ joint ventures
- exploit emerging new technologies
- extend brand name/ reputation in new geographic areas

### **3.5.2.4 Threat**

- entry of new competitors
- increasing intensity of rivalry
- slowdowns in market growth
- shift in exchange rate / trade policies
- new regulation – costs
- growing bargaining power of customer/ supplier
- shift in buyer taste
- demographic changes
- Aids
- vulnerability to industry driving forces

### **3.5.3 Weighted SWOT Analysis**

The key points listed above have been extrapolated to form a weighted SWOT analysis in order to analyse where major advantages can be identified according to the score tallied against each factor. Overall Spencer Gore has the infrastructure and potential to overcome threats and weaknesses in the market.

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

	Opportunities						Threats				+	-
	Large Demand for Property	FDI	Tourism Growth	BEE Alliances	Mergers & Acquisitions	New/ Innovative Products	Competition	Price Sensitivity	Aids	Political & Economic Issues		
<b>Strengths:</b>												
SGC expertise & knowledge	3	2	3	3	3	3	2	2	2	3	26	0
SGC Management skills	3	2	2	3	3	3	2	1	2	2	23	0
Established brand and integrity of SGC	3	3	2	3	2	2	2	2	0	2	21	0
Excellent credit record	3	3	2	3	2	1	2	1	0	1	18	0
2nd Largest Homebuilder in KZN	2	2	2	3	2	1	2	2	0	1	17	0
Existing low cost base	2	2	2	3	1	2	2	2	2	1	19	0
Situated in La Lucia	1	1	1	1	1	1	0	0	0	0	6	0
Member of MBA & NHBC	2	1	1	2	1	1	2	1	0	0	11	0
<b>Weaknesses</b>											0	0
Small management team	-1	-1	-1	-2	-2	-2	-2	-1	-1	-1	0	-14
Lack of capital	-3	-3	-3	-3	-3	-3	-3	-3	-1	-2	0	-27
Lack of exposure	-1	-1	-1	-2	-1	-1	-3	-2	0	-2	0	-14
Small trained/skilled workforce	-2	-2	-2	-2	-2	-2	-2	-1	-3	-2	0	-20
No black empowerment partner	-1	-2	-1	0	-3	0	-2	0	0	-3	0	-12
<b>Environmental Impact Scores +</b>	19	16	15	21	15	14	14	11	6	10	141	-87
<b>Environmental Impact Scores -</b>	-8	-9	-8	-9	-11	-8	-12	-7	-5	-10		

**Figure 3.6: Weighted SWOT analysis**

### 3.5.4 Competitive Strength Assessment

Spencer Gore is very well positioned to assume a leadership position in the RA&A market. The strengths accumulated within the company far outweigh the weaknesses. These may be enumerated as follows.

#### 3.5.4.1 Signs of Strength

- Resources – highly skilled management team and infrastructure
- core competencies – established track record in the industry with a reputation for reliability and quality
- competitive capabilities – aggressive and customer focused marketing
- competence in value chain activity – Just in Time ordering and tight site cost control
- strong/leading market share – well established in the northern suburbs of Durban

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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- pace setting strategy – reputation for speedy response and tight deadlines
- brand name/reputation
- growing customer base/loyalty
- well positioned in attractive market segments – figures support northern Durban area as profitable
- above average innovation ability
- creative, entrepreneurial management

### 3.5.4.2 Signs of Weakness

- Constant rivalry and threat of losing ground to competitors
- eroding market share
- slow revenue growth
- short financial resources – unable to pursue new opportunities
- too small to be major player in the construction industry

### 3.6 Client Needs and Expectations

In order to gain some empirical evidence of what the client's needs and demands are, Spencer Gore Construction devised a detailed questionnaire (sample attached as Appendix A). A non-probability sample was generated in order to gain opinions from people who had either had building work done or who were intending to do building work on their property. This was done in the following manner:

Firstly, the website maintained by the Planning Department of the City of Durban ([www.durban.gov/planning](http://www.durban.gov/planning)) was utilised to gather a database of people who had or were in the process of getting plans passed in the last few years. This was done by means of accessing tables by postal codes in the Morningside, Berea, Durban North, Musgrave and Woodlands areas. A random sampling of all data was done, and approximately 800 of the 1866 records were selected and questionnaires mailed to them.

In addition, in order to poll the northern suburbs of Durban, the Planning Department of the North Local Council provided a photocopy of the list of all plans that had been passed

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A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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in the previous year. Unfortunately this list did not include addresses, so the Municipal Rates Assessment was matched against Lot numbers on the Planning Department list and addresses were gathered in this manner. Some 500 questionnaires were mailed to a random sampling of the database collated.

In order to incentivise respondents, a prize of R15 000 of home renovations of their choice was offered to the winner of a lucky draw to be undertaken among all the questionnaires returned.

In all some 1400 questionnaires were mailed. Brochure stands were also placed in 20 different outlets all associated with home renovations, such as tile shops, paint shops, hardware shops, etc. The brochures all displayed a sticker advertising the R15000 prize on offer, and all had a questionnaire enclosed. Some 200 brochures were disseminated in this manner.

In addition, the questionnaire was also posted on the Spencer Gore web page, of which 2 responses were received. Of all the questionnaires posted, a response of only 120 were received. Of all the brochures displayed, only 6 responses were received.

The questions pertinent to this research have been isolated and conclusions may be drawn as follows:

Note: in all instances the 0 column represents a non-response to the question.

Question	0	1	2	3	4	5	6
How many quotes did you call for?							
Where:							
1 = 1 quote							
2 = 1 – 3 quotes							
3 = More than three quotes	2%	11%	76%	12%			

The majority of clients request between one and three quotes which is consistent with the company's empirical experience

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

Question	0	1	2	3	4	5	6
How did you find your builder?							
Where:							
1 = Architect/Engineer referral							
2 = Newspaper advertisement							
3 = Friend/family referral							
4 = Builder's advertising board on site							
5 = Estate agent							
6 = Yellow pages	1%	19%	11%	42%	11%	4%	5%

The majority of respondents indicated that the builder was referred to them by either friends or family members, which, again, is consistent with empirical experience.

Question	0	1	2	3	4	5	6
How long do you think it should take for a builder to give you a quote?							
Where:							
1 = Less than one week							
2 = 1 – 2 weeks							
3 = 2 – 4 weeks	2%	52%	40%	7%			
How important was a quick response with the quote to you?							
On a scale of 1 – 5 with 1 as not important and 5 as very important	1%	2%	8%	24%	33%	33%	

The majority of respondents indicated that they required a fairly quick response to their request for a quote, and most rated this high in importance.

Question	0	1	2	3	4	5	6
How long after getting the quotes did you appoint a builder							
Where:							
1 = 1 week							
2 = 1 month							
3 = over 1 month	1%	49%	44%	6%			



A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

The indication here appears to be that once the quotes are in, a decision to commence with the building operation follows fairly soon thereafter. Taking into consideration the fact that most builders' quotes are only valid for 15 days, this seems sensible.

However, empirical experience suggests that this is not in fact the case as Spencer Gore is often required to rework quotes several times as the client changes their minds frequently before they accept the final quote. The process of reworking quotes can continue for over two months.

Question	0	1	2	3	4	5	6
----------	---	---	---	---	---	---	---

Who made the final decision regarding the builder?

Where:

1 = Male head of house

2 = Female head of house

3 = Joint decision

1% 18% 7% 73%

In 73% of instances the decision regarding the builder was made jointly, however when a single head of household made the decision, the male head outweighed the female head.

Question	0	1	2	3	4	5	6
----------	---	---	---	---	---	---	---

What was the main influence on your final selection of a builder

Where:

1 = Price

2 = Previous client referrals

3 = Friend/architect/engineer referral

4 = Established builder in the area

5 = Builder's guarantees/professionalism

1% 28% 20% 13% 13% 25%

How important was the price of the contract to you?

On a scale of 1 – 5 with 1 as not important and 5 as very important

2% 3% 5% 23% 36% 30%

How important was the quality of the finished building to you?

On a scale of 1 – 5 with 1 as not important and 5 as very important

2% 2% 1% 2% 17% 76%

How important was the builder's previous client referrals to you?

On a scale of 1 – 5 with 1 as not important and 5 as very important

2% 9% 9% 26% 27% 29%

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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Question	0	1	2	3	4	5	6
How important was the professionalism of the builder to you? On a scale of 1 – 5 with 1 as not important and 5 as very important	1%	2%	5%	8%	29%	56%	

This question was combined with various forms of qualifiers in order to gauge not only what the governing factor was, but how important it was as well. The majority of respondents said that price was an important consideration, and this was borne out by the 28% who nominated price as the most important choice factor. This is also borne out by empirical experience where quotes are often reworked to reduce costs.

While quality was deemed very important to all clients, and builder’s professionalism also gathered a majority vote, only 25% of respondents indicated professionalism and guarantees as important. This becomes more interesting in the next question.

Previous client referrals were considered neutral, although 20% of respondents indicated that they did use previous client referrals before making their final decision.

Question	0	1	2	3	4	5	6
Did your builder offer any warranties with his work? Where: 1 = Yes 2 = No 3 = Don’t know				2%	49%	37%	13%
How important was it for the builder to be a member of a regulatory body (e.g. NHBRC, MBA, etc.)? On a scale of 1 – 5 with 1 as not important and 5 as very important	1%	13%	9%	26%	25%	27%	

With quality in the previous group of questions being extremely important, it is interesting to note that only 27% of respondents deemed it important for the builder to be a member of a regulatory body and only 49% of respondents stated that their builder was a member of a regulatory body.

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A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

Question	0	1	2	3	4	5	6
----------	---	---	---	---	---	---	---

Do you think the builder simplified the project with advice, suggestions, etc.

Where:

1 = None

2 = Some value

3 = Very helpful

4 = Excellent service and assistance      2%   18%   27%   34%   16%

How important was the builder's advice to you?

On a scale of 1 – 5 with 1 as not important and 5 as very important      2%   4%   5%   19%   34%   38%

The majority of respondents felt that builder's advice was important but only 16% of them appeared to receive satisfaction in this area.

Question	0	1	2	3	4	5	6
----------	---	---	---	---	---	---	---

Did the builder finish on time?

Where:

1 = Finished before time

2 = Finished on time

3 = Was slightly late with completion

4 = was way over promised completion date      3%   3%   27%   38%   26%

How important was finishing on time to you?

On a scale of 1 – 5 with 1 as not important and 5 as very important      2%   3%   3%   26%   33%   34%

Finishing on time was deemed high in importance, but only 27% of respondents responded positively. 38% had overruns on completion dates with 26% responding that the builder was way over completion date.

Question	0	1	2	3	4	5	6
----------	---	---	---	---	---	---	---

What was the level of tidiness on site?

Where:

1 = Very untidy

2 = Slightly untidy

3 = Tidy

4 = Very neat and orderly      3%   11%   34%   38%   12%

How important was tidiness on site to you?

On a scale of 1 – 5 with 1 as not important and 5 as very important      2%   2%   8%   13%   28%   48%

A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

48% of respondents stated that tidiness was very important, while only 38% appear to have been satisfied with the level of tidiness on site.

Question	0	1	2	3	4	5	6
What was the overall standard of the complete work? Where: 1 = I was very happy 2 = A few problems that were quickly sorted out 3 = Some problems that I ignored as they were not important 4 = Many problems that were not sorted out 5 = I am or was involved in a dispute with the builder to get problems sorted out	2%	21%	43%	18%	9%	6%	

Only 21% of respondents stated that they were very happy with the standard of the completed work however 43% felt that the few problems were quickly sorted out. The concern lies in the 9% who never had their problems sorted out and the 6% who are or were involved in a dispute getting the problems sorted out.

Question	0	1	2	3	4	5	6
Would you use the same builder again? Where: 1 = Without hesitation 2 = If I could not get someone else 3 = Under no circumstances	4%	58%	20%	18%			

When asked if they would use the same builder again, 58% responded positively, an alarming 18% responded very negatively.

Question	0	1	2	3	4	5	6
Would you recommend the builder to anyone else? Where: 1 = Never 2 = Only as acceptable 3 = Yes – excellent	4%	15%	34%	47%			

While 58% of respondent stated that they would use the same builder again, it would appear that only 47% would refer the builder unhesitatingly.

### **3.7 Conclusion**

The building industry in South Africa, and in particular in the Durban area is in a growth stage. The residential housing market is particularly strong and the RA&A sector of the residential market forms a large portion of consumer expenditure.

While there are several small operators in this sector it is evident that there is no market leader and the industry is fragmented and unregulated. This means that many builders, particularly those operating in the informal sector, have no access to office facilities or credit facilities. Any work undertaken is driven by the amount of capital the builder has on hand in order for material to be purchased to complete the project. This has also led to many jobs being abandoned due to the builder running out of funds, which has not done the creditability of the industry any good.

In the formal sector there is a lack of qualified foremen to handle projects, and skilled, trained sub-contractors are difficult to retain. Coupled with lack of capital to launch larger projects, the formal sector is again, fragmented and volatile. Very few builders in the formal sector have an established infrastructure with support personnel.

Having undertaken a detailed survey of the public regarding how they choose a builder, what factors are deemed more important than others, and the level of service they have received in the past, Spencer Gore is in a position to focus on this market and fulfill their needs more accurately, without wasting resources on items that were previously assumed to be of importance.

Spencer Gore Construction is well positioned to assume the role of leadership in this field. Their technical expertise and managerial skills ensure the necessary controls in terms of quality and costs will be maintained. The company is well branded with a reputation for quality and reliability. While access to capital is always a problem, it is envisioned that within the near future, sufficient capital will have been amassed and this, coupled with an excellent credit reference among suppliers, will enable the company to pursue a concentrated growth strategy.

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## **CHAPTER 4: PROPOSED FRANCHISING STRUCTURE**

### **4.1 Introduction**

In order to maximize the advantages of franchising as a growth medium, it is necessary to engineer the design to fit the individual model. As a concept, franchising has proved enormously successful, but in the context that this dissertation proposes, careful thought needs to be given to each aspect of the franchise model in order to tailor it to meet the specific needs of the market.

In the normal course of events a franchisee can be trained to manage the franchise, but essentially due to the technical nature of the building industry, the required technical expertise will be a qualifying factor. The franchise model will be open to applicants either currently operating in the industry, or emerging from a training institution with the necessary technical skills.

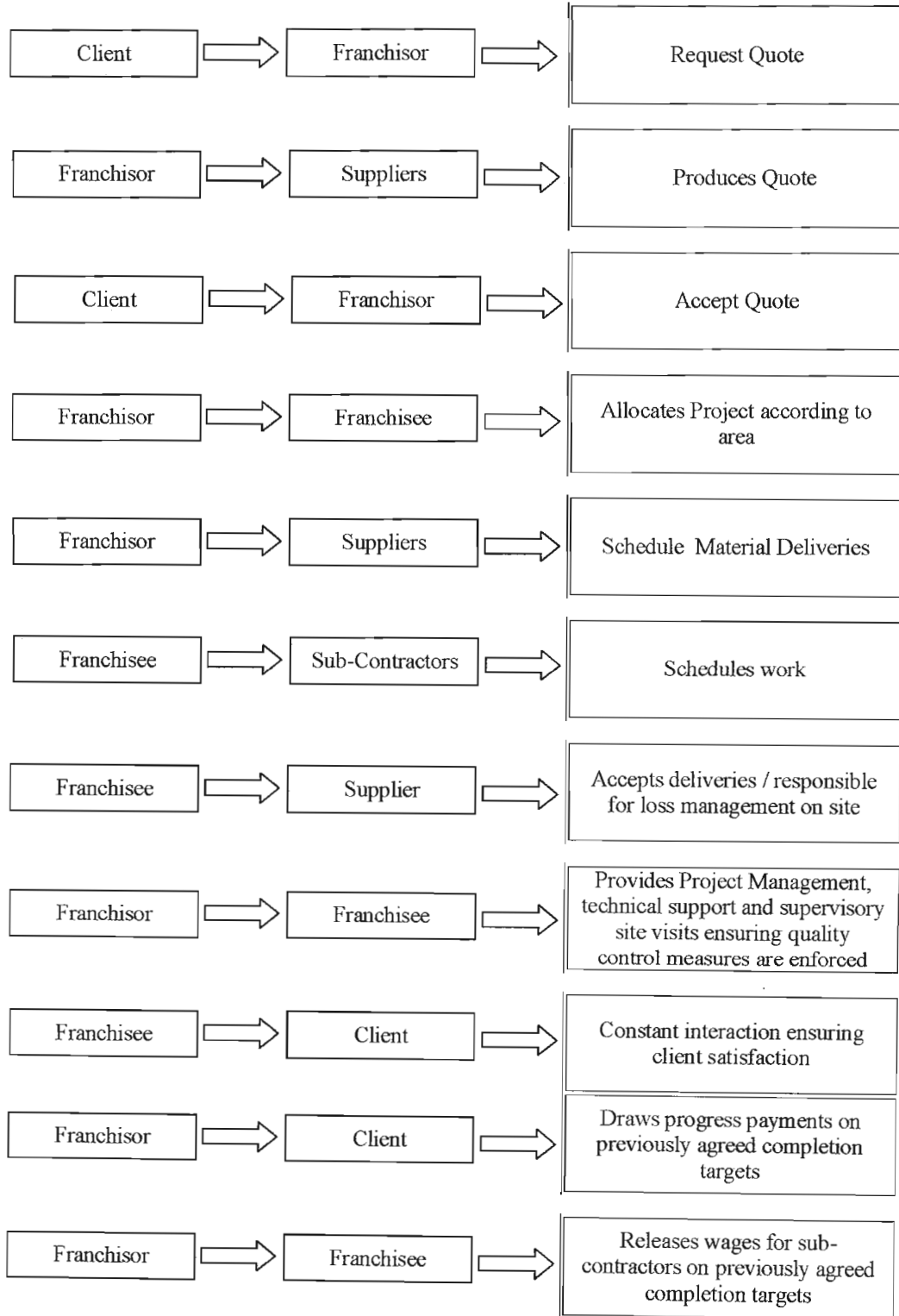
One of the critical success factors in maintaining a successful franchise operation is ensuring that all franchisees are imbued with the same sense of quality driven excellence that currently dominates the Spencer Gore business model.

### **4.2 Franchise Design**

The franchise envisioned will differ substantially from the current standard model. While training will be given to franchisees on all aspects of running and maintaining a successful business operation, much of the administrative function will be handled at franchisor level in order to free up the franchisee to oversee the actual site management.

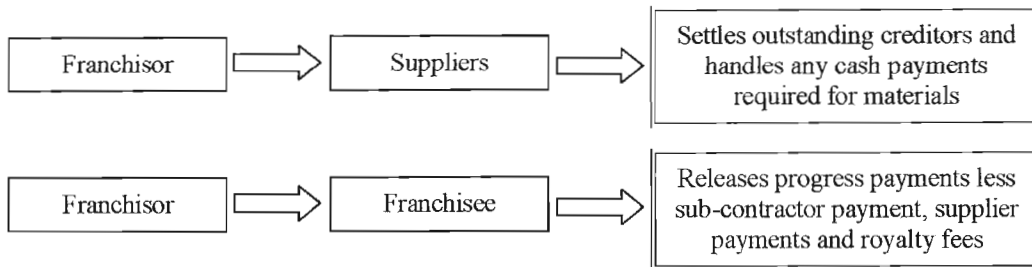
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The franchise design will be formulated along the following parameters:



## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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**Figure 4.1: Franchise Design**

The franchisor would supply the administrative infrastructure necessary for the builder to run the franchise. One central switchboard operator would be responsible for liaison between client, franchisee and franchisor. The franchisee would no longer have the responsibility of maintaining a physical office as a central administration facility would exist. The franchisee would utilise the franchisor equipment and facilities. Projects would be costed centrally, and costs captured at head office by a data capture clerk. This would enable stricter cost control measures at all times.

Furthermore, with a central switchboard facility the franchisee no longer has to rely on his cell phone to maintain contact with clients and new business would not be lost due to poor communications.

In addition, as has been shown, new business stems mainly from referrals and builder activity in the area. By operating under one banner, with each site clearly identified as a Spencer Gore site, visibility is heightened and client awareness of the brand is maintained.

By doing all the quotations for new projects at head office level, this ensures that the profits will be constant barring unforeseen events. Because the quotes are done at one central point the need for constant telephone calls for current material prices will be alleviated as prices will be constantly monitored.

The franchisor would achieve economies of scale by utilising one secretary for 10 franchisees and one data capture clerk for up to 20 franchisees. One Quantity Surveyor

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could cost up to 20 new projects a week and one project manager could handle up to 15 sites a week.

By collecting progress payments on behalf of the franchisee this means that all financial obligations such as credit control, etc are removed from the franchisee. It also means that the franchisor does not carry the risk of being stuck with outstanding creditors that are not settled by the franchisee, thus costing the franchisor in terms of credibility.

The franchisor earns income firstly by royalty payments, secondly by interest earned on progress payments collected and held for thirty day payment to suppliers, and thirdly from supplier discounts allowed.

A fourth revenue stream could be generated at a later phase of the franchise operation where purchasing power is such that additional discounts could be sought from suppliers due to the total buying power of the franchise and a portion of these discounts may be retained by the franchisor.

### **4.3 Franchisor Requirements**

The franchisor would be obliged to ensure that sub-contracting teams are available and trained for deployment between franchisees.

The franchisor would be responsible for maintaining a minimum of two heavy-duty vehicles for emergency material deliveries between sites.

The franchisor would be responsible for ensuring adequate project management and technical skills and support are available to franchisees when needed.

The franchisor would be responsible for ensuring that new clients are serviced efficiently and that projects are allocated in an unbiased manner between areas.

The franchisor would be responsible for ensuring that an adequate head office staff be maintained to field telephone calls, cost projects, pay suppliers and provide client service.

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The franchisor would have to be seen to be ethical and honest in all dealings with franchisees as trust would play a vital role in the success of the franchise.

The franchisor would operate with total transparency at all times towards franchisees.

#### **4.4 Franchisee Requirements**

The most important factor in selecting franchisees is identifying the characteristics that would best suit the franchising model. The most important factors identified are as follows:

1. Profile the past. Get a clear history of the entrepreneur's roots, including credit history and working track record. Key qualities are responsibility and reliability.
2. Ensure that the franchisee is clear on the demands of his new role and the expectations of the franchisor regarding performance and quality standards.
3. There must be a high degree of fit between the franchisee's goals and the strategic direction of the franchisor.
4. The franchisee must show commitment and determination to succeed.
5. The age of the franchisee is not particularly relevant, although experienced builders would be preferred. It may be possible to take on potential franchisees after graduation from an educational institution, and train them in positions of trainee project managers while they accumulate sufficient capital and expertise in order to open their own franchise.
6. There should be a minimum qualification in terms of experience and education for becoming a franchisee.
7. The franchisee must be aware of the importance of compliance with franchisor goals
8. The franchisee must have the financial resources to purchase a franchise. It is envisaged that initially, franchises would be relatively inexpensive, with higher royalties while the business model is being promoted and marketed. Once a broad enough base has been established, the buy in would be higher but the royalties

would be lower. Initial franchise costs would cover the franchisor in terms of creditors costs to that franchisee, while also ensuring that the franchisee has sufficient reserves to cover labour costs.

9. Technical training in all aspects of building will be offered to franchisees in order to improve skill levels. In instances where the franchisee already has a high skill level it may be prudent to place a trainee at no labour charge to the franchisee, with his team in order to acquire relevant skills.

The franchisee must be made aware of the fact that success is not guaranteed. Hard work is still necessary and the franchisee must not only honour the letter of the contract, but the spirit as well.

#### **4.5 Conclusion**

Full cooperation and commitment on the part of both the franchisor and the franchisee is an essential foundation on which to base the business model. Providing franchisees with a tested and proven operating model and ensuring that the franchisee follows the model, while not guaranteeing success, substantially increases the odds of success. Franchising is not for mavericks with the need to create or reengineer to express their creativity. Highly entrepreneurial people do not make good franchisees as they have difficulty conforming to the rigidity of the system. However, it is important for the franchisor to keep an open mind regarding input from franchisees as some of their concepts may be correct and if worked into the system could benefit all parties.

Franchisees must understand the environment in which they operate. Consumers have other options to choose from and are hesitant to spend their money. Excellence in service and quality is Spencer Gore's unique selling point and it is critical that this credo is carried through to all franchisees.

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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Franchisees should have very clearly defined personal goals and the business is a vehicle that will help them achieve their desired quality of life. This has to start with understanding what it is they really want.

The major benefit of franchising is the support system provided by the network. Taking advantage of the help and advice available can save time and headaches.

## **CHAPTER 5: RECOMMENDATIONS AND CONCLUSION**

### **5.1 Introduction**

According to Thompson Strickland (2003) there are ten golden rules of strategy. These may be summarised as follows. Firstly the strategy must enhance competitive position for long term. Secondly, prompt adaptation to change in market condition, unmet customer needs, buyer wishes, emerging technology alternatives and competitor initiatives is essential. Thirdly, the company must invest in sustainable competitor advantage. Fourthly, avoid over optimism. Fifth, don't underestimate rivals. Sixth, it is better to attack competitor's weakness than their strength. Seventh, only cut prices if there is a cost advantage. Eighth, open meaningful gaps in quality, service and performance if differentiating – establish what is important to customer! Ninth, avoid being stuck in the middle: lower cost with greater differentiation or broad/narrow market appeal. Lastly, watch out for rival retaliation.

The proposed franchising business model has a strategic fit with these ten commandments, but in order to gain a deeper understanding of certain aspects, further analysis needs to be done.

The business needs to be ranked in the context of both historical and future prospects. Resource allocation needs to be assessed in terms of industry attractiveness, competitive strength, strategic fit, resource fit and performance potential and this now follows.

### **5.2 Attractiveness/Profitability of Industry**

It has been shown that the construction industry is currently a very attractive sector to be involved in. Growth potential is high and the long term forecast is favourable. With strict cost control measures and constant vigilance on site, profitability can be reasonable high. Competition in the industry is, however, fierce due to the low barriers to entry, although Spencer Gore Construction has successfully maintained a high profile and has become a well-branded business model. They can be considered well entrenched in the building sector. There is an enormous potential to capitalise on vulnerabilities of weaker

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## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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rivals due to superior management and technical skills as well as reputation for quality and reliability. Careful management has ensured that they are well positioned to defend themselves against unattractive industry factors such as spiraling costs, shrinkage and labour shortages.

While there is always some degree of risk or uncertainty in the building industry, mainly due to fluctuating interest rates or government regulations, forward planning and flexibility in operating structures ensure survival.

The severity of problems confronting the building industry lie mainly in the poor perception the public has of the individual operators. This has been primarily due to the fragmented nature of the sector, and constancy of purpose and excellence of service will alleviate this poor perception. One of the major challenges facing the operation is to shift customer focus from cost sensitivity to quality demand. In essence what the company needs to establish in the mind of the consumer is that while Spencer Gore is not necessarily the cheapest, the peace of mind afforded by utilising their services is priceless.

It is perceived that the continued participation of Spencer Gore in the RA&A sector and the increased exposure offered by franchising the business model will add to their ability to be successful in other sectors of the building industry, such as developments, new houses, etc.

A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

**5.3 Industry & Competitive Analysis Summary**

<b>Dominant Economic Characteristics</b>	<b>Competition analysis</b>	<b>Competitive Position of Major companies</b>	<b>Competitor Analysis</b>	<b>Industry Prospects &amp; overall attractiveness</b>
<ul style="list-style-type: none"> <li>- Large Market / enormous growth</li> <li>- geographic scope is national, even stretching into Africa</li> <li>- the number and size of buyers and sellers is enormous</li> <li>- pace of technical change and innovation applies more to commercial building rather than the RA&amp;A market</li> <li>- economies of scale are very real in terms of buying power and advertising exposure</li> <li>- experience curve effects become apparent when managing several projects simultaneously. Also in terms of quoting on new projects</li> <li>- capital requirements remain steep but not insurmountable</li> </ul>	<ul style="list-style-type: none"> <li>- rivalry is intense but SGC is one of the few reputable / reliable operators with a solid base of satisfied customers giving constant referrals</li> <li>- threat of potential entry remains high as barriers are low, but once the franchise is established, new entrants will be forced to compete for the smaller contracts as the buying power of the franchise will make their quotes extremely competitive</li> <li>- power of suppliers is in general not high as there are several outlets vying for the same business. Speciality products, however, remain a problem, particularly PVC and concrete</li> <li>- power of customers is high – it remains essential to keep customers satisfied</li> </ul>	<ul style="list-style-type: none"> <li>- There are no major operators in the RA&amp;A market. This means it is wide open to a concentrated growth strategy</li> </ul>	<ul style="list-style-type: none"> <li>- Study of the market has shown that competitors appear in the market and compete for business based on a cost strategy. This enables quick market penetration but essentially means they are working for turnover. When a reversal occurs (which is frequent in the industry) there is no capital reserve to carry them through and they disappear, to reappear a couple of years later under a new name, but, it would appear, always the same strategy.</li> <li>- It is important to watch the competition closely especially when tendering on larger projects in order to ensure complacency does not occur.</li> </ul>	<ul style="list-style-type: none"> <li>- The RA&amp;A industry is generally attractive due to the lack of regulation, low barriers to entry and potential of reasonable profits</li> <li>- It is, however, unattractive in that it requires long hours, dedication, tight quality and cost controls, good management skills and administrative abilities.</li> </ul>

#### **5.4 Industry Driving Forces**

While the property industry has experienced a surge of Internet and e-commerce opportunities, the building industry has not followed suit. There is very little opportunity for online procurement, most of the Internet sites being brochureware only. The majority of business is still done the old fashioned analogue way.

The building industry experienced a slump in the 80's – 90's, but has recovered and is currently booming. The long-term prognosis is good especially in the light of government emphasis on housing and infrastructure in order to boost employment.

Product innovation becomes more critical in labour intensive industries such as the building industry. Unfortunately, especially in the RA&A market, there is very little that can be done cost effectively to shorten the building process.

Capital requirements always remain a high priority as building materials are expensive and the builder can only recover his costs when he gets his first progress payments. Often suppliers will not grant credit, or the client withholds payment, leaving the builder in a precarious financial position.

Logistics are a significant factor – the timing of material ordering in order to minimize time on site, as well as space logistics – often building sites have small yards or verges and the builder is constrained by how much plaster sand/building sand or bricks can be retained on site. This often entails frequent small deliveries, the timing of which becomes critical.

The learning or experience curve is one of the breaking points of many operators in the business. A calculation error when quoting, a line plotted inaccurately, or a wall out of synch can quickly spell disaster on a building site with a resultant loss on the entire project.



## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

Diffusion of technical know-how is difficult at best. The highly competitive nature of the industry means that secrets of success are closely guarded and many builders learn by little more than trial and error.

Government regulations play an important part in the industry and building inspections must be carried out on all projects. In addition, there is a proposal afoot to regulate the building industry and apply a minimum qualification to all builders setting up offices.

Changing society attitude and lifestyles have played a greater role in recent years in the RA&A sector. Two income families have meant more disposable income and a more affluent lifestyle. While often it does not enable living in the most affluent suburbs, it has afforded many households the ability to increase their living space and upgrade their existing structures.

The life cycle stage of the building industry is definitely in its maturity, however it is still a growth industry.

### 5.5 Performance Gap Analysis:

INDUSTRY MARKET POTENTIAL					
Current Sales	Competitive Gap	Usage Gap	Distribution Gap	Product Line Gap	Increases to IMP →
<ul style="list-style-type: none"> <li>- Defend current market position</li> <li>- Increase turnover</li> </ul>	<ul style="list-style-type: none"> <li>- Penetrate direct competitors positions</li> </ul>	<ul style="list-style-type: none"> <li>- stimulate non-users – make new clients aware of the potential of their houses if extended</li> <li>- stimulate light users – get clients to increase the intended extensions</li> <li>- increase amount used on each occasion – offer advice and suggestions on how to improve on what they have decided on</li> </ul>	<ul style="list-style-type: none"> <li>- expand coverage – move into more areas</li> <li>- expand intensity – gain more exposure in existing target areas</li> <li>- expand exposure -- increase advertising</li> </ul>	<ul style="list-style-type: none"> <li>- fill out existing product lines – expand into new houses and developments</li> <li>- create new product line elements – offer more holistic service such as architects, landscape gardeners, interior decorators, etc</li> </ul>	<ul style="list-style-type: none"> <li>- natural changes</li> <li>- new uses or user segments</li> <li>- innovative product differentiations</li> <li>- adding new product lines</li> </ul>

**5.6 PIMS Analysis:**

	<b>Bad</b>		<b>Good</b>
Relative share	Weak	X	Strong
Relative Quality	Inferior	X	Superior
Capital Intensity	High	X	Low
Capacity Utilisation	Low	X	High
Productivity	Below par	X	Above par
Real market growth	Decline	X	Growth
Marketing intensity	High	X	Low
Bargaining power	Weak	X	Strong
Logistics	Complex	X	Simple

**5.7 Strategic Options**

The building sector is a mature industry, but is subject to fluctuations in growth. In a recession growth is slow, but in a boom growth is rapid. It is critical therefore, in envisioning a long-term strategy, that cognizance is made of this tendency to fluctuate in order to ensure survival.

Strategy in recession must take account of more head to head competition for market share, the fact that buyers are more sophisticated and driving harder bargains and there is a greater emphasis on cost and service. A slowdown in growth leads to overstaffing, and new innovative approaches need to be investigated. Profitability may fall temporarily or permanently, leading to the demise of the business. It is during this period that more mergers and acquisitions occur, driving out the weakest firms.

Strategic moves should include pruning out marginal operations, placing a stronger emphasis on value chain innovation, customization of product and service, using advanced technology or new techniques and a focus on cost reduction.

The building industry is very fragmented - there is an absence of a market leader and brand recognition is a long and intense process. The market demand is extensive and diverse, ranging from commercial to residential, new buildings, alterations and additions, from R10 000 through to hundreds of millions of Rands being spent on a single project.

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## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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In the RA&A market in particular the industry is crowded, barriers to entry are low, there are few economies of scale and specialization or a unique selling point is essential. Strategic options include construction/operation of “formula” activities such as franchising, specialising in product or customer type and a focus on limited geographic areas.

Spencer Gore currently intends following a strategy for pursuing and sustaining rapid growth. This is achieved through a diverse strategy portfolio, namely, in order to fortify and extend their position they should add new products, enter new geographic areas, launch an offensive attack and leverage existing resources and capabilities. All of the above strategic elements enjoy a good fit with the franchising business model and the prospects are therefore excellent of fulfilling the company vision of growth and leadership within the industry.

### **5.7.1 Value Chain Analysis**

A value chain analysis relates activities of the business to an analysis of competitive strength in an attempt to discover synergy – how much value for money can be attained from reconfiguring linkages. The value chain is split into two types of activities, primary and secondary, as follows:

#### **5.7.1.1 Primary Activities**

Inbound logistics can be more closely controlled especially stock control on site. Equipment such as wheelbarrows, hammers, chisels, drills, etc, which are easily mislaid or purloined, should be kept in a locked trunk and signed out on a daily basis.

Price comparisons should be undertaken on a regular basis, even among favoured suppliers to ensure that the best terms are being offered. Suppliers should be constantly monitored to ensure consistency of quality and promptness of delivery.

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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Any material delivered on site should be carefully checked and signed for and measures taken to secure items on site until used. All unused or excess items should be cleared off site and placed in the warehouse for future use.

Operations should be carefully monitored to ensure no duplication of tasks and no redundancy of labour. Variations to plan should be costed and the relevant sub-contractors informed of any changes to avoid breaking down and redoing work. Measurements on site should be constantly checked to ensure adherence to specifications.

Quality control in terms of building standards must be rigorous to maintain the image of the company. The site must be kept tidy and all rubble cleared off site on a regular basis.

Outbound logistics do not apply in this instance.

Sales and marketing are integral aspects in every project. Each and every member of the workforce is an advertisement for the company. This means that at all times every staff member on site must maintain a courteous demeanor, remembering that the workspace being occupied is the client's home and should be treated with respect.

The main source of new business is from client referrals and as such, the conduct of the company on site is its own best advertisement.

Constant research into market trends must be undertaken to ensure that profitable areas are identified and targeted ahead of the competition.

By offering additional services to the client, Spencer Gore will ensure continued loyalty and constant referrals. These services may include offering advice to prospective clients from the time the client first envisages making alterations to their home. By becoming a source of information and advice at the outset, the company assumes the role of "partner" in the undertaking and the client learns to trust the builder and respect their professionalism.

Offering unconditional guarantees on all work done also increases the level of confidence that the client has in the company. This, accompanied by regular site visits and inspections, ensuring that the client is kept updated of all developments, as well as giving the client a forum to voice concerns, maintains cordial relations throughout the duration of the project.

By including extra services such as interior decorating referrals, horticultural referrals, assisting clients in selecting sanitary ware, tiles, etc., the stressful nature of these major decisions are relieved as the client can benefit from the experience and technical expertise of Spencer Gore.

All complaints, no matter how trivial, should be treated with respect and investigated. At no time should the customer feel that his concerns are inconsequential. Care should be taken to reassure the client that any problems will be attended to promptly.

#### **5.7.1.2 Support Activities**

Research into new technology or systems should be ongoing to ensure that Spencer Gore remains at the leading edge of design innovation. Clients demand to have access to the latest techniques or trends in lifestyle design and lack of technical expertise in new areas will lose business.

Spencer Gore needs to capitalize on specialist skills that are unique to the company and not easily replicated, such as finishes that require a specialist craftsman whose services are only available to the company. Currently the company enjoys one such feature, which has become the company trademark. It enjoys the benefit of being inexpensive if done properly and easy to maintain.

The CEO's home was extensively altered by Spencer Gore and is used as a model for prospective clients to see what features and finishes are available to them. As a working model it is an excellent advertisement for the company.

Equally important in the technology field, is remaining current with computer software developments. Database maintenance is critical to ensure accurate and fast costing on projects.

Human resource activities cannot be ignored. Attention to detail when hiring and training staff is vital. All members of staff, as mentioned previously, act as ambassadors for the company values. Well-trained, motivated employees with ingrained company ethics are the best advertisement for the core values the company projects.

Good general administration ensures smooth running on a daily basis. Accounting practices should conform to GAAP and be transparent to all parties. At no time should Spencer Gore deal in underhand maneuvering to win a contract. All VAT, taxes and levies must be both charged out and paid over to regulatory bodies.

Suppliers should be paid promptly and strong relationships forged to ensure loyalty and thus good prices and fast delivery. Strategic alliances with suppliers may be considered in instances such as general building supplies, for example cement, brickforce, etc. These items form a large portion of building expenditure and prompt, often daily deliveries are essential.

Accurate, timeous project costing reports should be made available on demand to all project managers and other members of management teams to ensure that material costs are kept under control and that progress payments can be accurately calculated to cover current expenditure.

### **5.7.2 Industry Attractiveness Test**

Before making long-term decisions regarding future strategy, one of the most important questions to ask is: is this a good business to be in?

The long-term growth prospects of the building industry are favourable. South Africa is enjoying a period of infrastructural growth that can only benefit the construction industry as a whole.

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## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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While competitive conditions in the RA&A market are extreme, penetration into the market, once achieved, must be maintained by ongoing attention to quality and customer service. This is what differentiates Spencer Gore Construction and has become one of its key success factors.

The size of the market is vast and there is more than enough scope for rivals to enter the market without damaging Spencer Gore market share.

Emerging opportunities include the amount of development in the north of Durban, together with the development of the new airport. Housing in this area is set to boom. The growing trend toward secure gated communities also ensures that the north of Durban will continue to be a high demand area for the more affluent sector of the population.

Threats in the building industry include the potential for a recession and another upswing in interest rates. Spencer Gore Construction managed to survive both of these eventualities in the previous decade, and has the management skill and expertise to survive again should the need arise.

The only seasonal factor affecting the building industry is the Christmas shutdown. This means that all projects have to be completed or be very near completion by mid-December. Often the month of December is fraught with delays and last-minute rush orders as all builders scramble toward completion. The company, through experience, caters for this eventuality when timing projects in the last quarter of the year. The second problem arises when starting out the new year. January and February become very slow months unless projects are in hand at the close of the year to start off the new year. Clients only start requesting quotes in mid-January and generally only make a decision to start in mid-February. Allowance must be made to cover all expenses during this yearly start-up period.

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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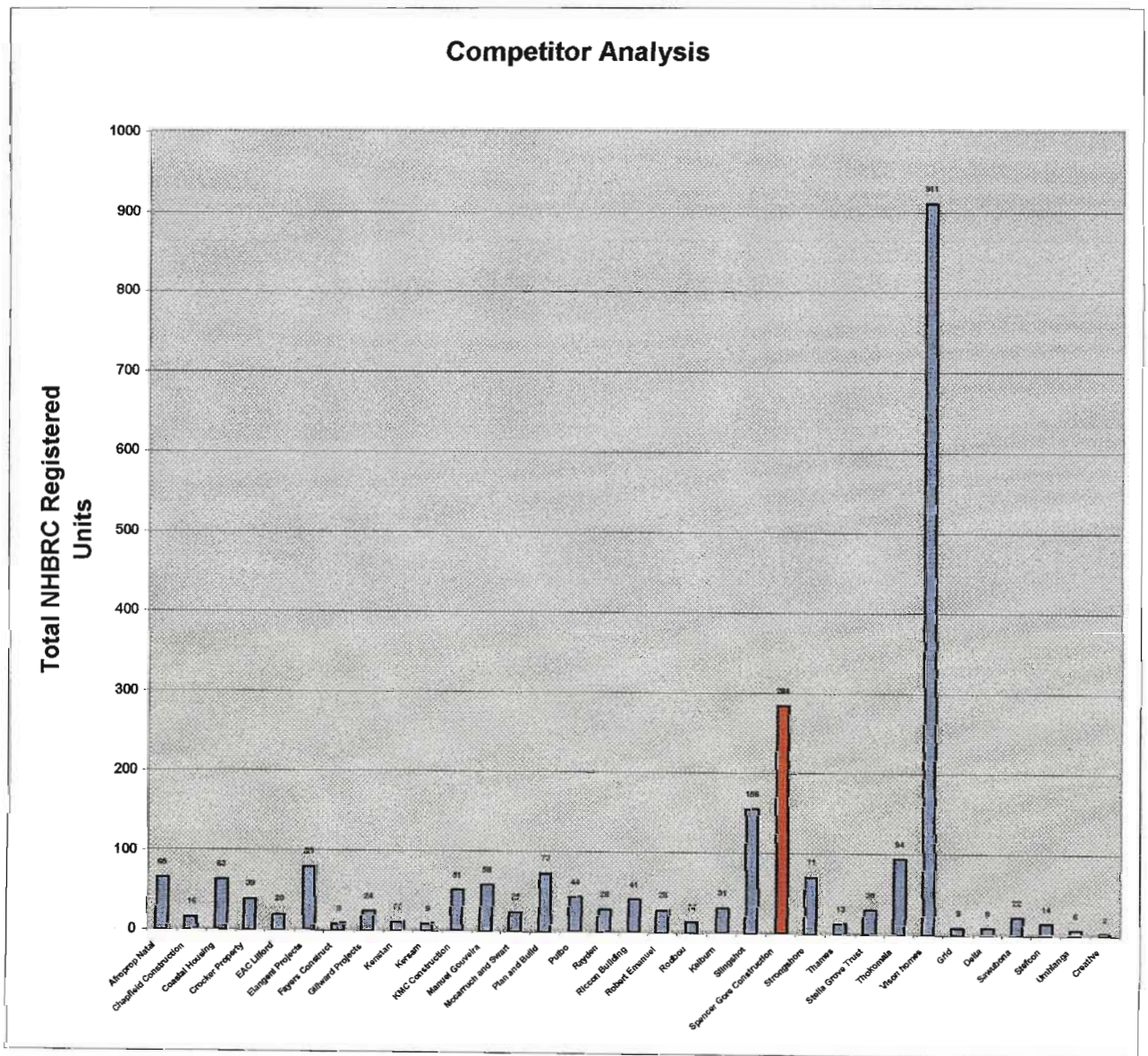
Resource requirements to starting up are low but to maintaining a profitable and growing business are high. While most of the more expensive equipment is hired on a daily basis, there is still the cost of sourcing materials, and vehicle operating expenses. Mobility is crucial in the building industry and is often the downfall of contractors. Vehicle breakdowns are costly not only in terms of the repair itself but also in lost time on site. The smaller builder relies heavily on using his vehicle to transport goods and labour between sites, and any delays can cost time penalties on non-completion of the project.

### **5.7.3 Competitive Strength Test**

The relative market share of Spencer Gore Construction is currently fairly high. The only source of statistics available is from the NHBRC that lists new homes built. The attached graph shows Spencer Gore Construction (in red) as one of the leading builders in the province.



A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector



**Figure 5.1: Total NHBRC Registrations**

While only some one third of the nearest rival, Spencer Gore Construction has maintained a respectable lead over the balance of construction companies in the region. This graph depicts number of houses, not the value and unfortunately these statistics per competitor are impossible to come by.

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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Again, in terms of costs in comparison to competitors, this is equally difficult to ascertain. The only reference available would be uninterrupted operation in the industry, accompanied by growth, which again places Spencer Gore in a respectable mid-position in the region.

The ability to match and/or beat rivals in the building industry is unquestioned. It is one of the few companies operating in the market offering professionalism, service excellence and stringent quality controls. It is only in areas where clients are extremely price sensitive and are willing to cut corners that Spencer Gore cannot and will not compete.

Spencer Gore has the ability to exercise bargaining leverage with key suppliers due to their excellent credit history and bulk buying capacity. Constant monitoring of supplier prices ensures profitability. Strong alliances have been formed with key suppliers, especially in areas where demand for the goods is high, and several suppliers have assumed the role of business partners and treat Spencer Gore as a preferred client.

The competitive assets and competencies of Spencer Gore are designed to match industry key success factors as closely as possible. Brand name recognition and reputation are protected vigorously. Profitability is closely monitored on all projects. There is a uniquely strong knowledge of customers and markets due to research undertaken to deepen understanding of client needs. A loyal and long standing, skilled workforce enhances Spencer Gore's unique production capabilities. Financial resources are improving and the calibre of management is very high.

A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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<b>Competitive Strength Measure</b>	<b>Weight</b>	<b>Strength Rating</b>	<b>Weighted Strength Rating</b>
Relative market share	0.15	7	0.11
Costs relative to competitors	0.20	8	0.16
Ability to match rivals on key product attributes	0.05	8	0.04
Bargaining leverage with suppliers/buyers; caliber of alliances	0.10	9	0.09
Strategic fit relationships with sister businesses (RA&A / new housing / development projects)	0.15	9.5	0.14
Technology and innovation capabilities	0.05	8	0.04
How well resources are matched to industry key success factors	0.10	7	0.07
Brand-name reputation/image	0.10	8	0.08
Degree of profitability relative to competitors	0.10	8	0.08
Sum of the assigned weights	1.00		
<b>Competitive strength rating</b>			<b>0.81</b>

**Table 5.1: Competitive Strength Rating - Thompson Strickland (2003)**

According to Thomson Strickland (2003) a competitive strength rating of above 6.7 is a strong market contender and they consider this to be a valuable consideration when deciding where to steer resources.

#### **5.7.4 Strategic Fit Test**

By franchising, Spencer Gore will enable numerous value chain match-ups, among which would be an ability to combine performance and cost savings through economies of

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## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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scope and scale. Purchasing leverage becomes exponentially greater. The ability of franchisees to share facilities ensures their greater profitability as well as reduced administration functions. Central distribution channels ensure speed and accuracy of material delivery. Skills transfer between franchisees is enhanced, along with the linkup to a well-respected, reputable brand.

The ability to create new competitive capabilities and leverage resources is increased by the pooled knowledge and experience of both the franchisor and franchisees.

### **5.7.5 Resource Fit Test**

A financial fit exists when the proposed strategy adds to company strength. The company must have resources to support the businesses as a group. In franchising there will always be outlets that are cash hogs or cash cows. The challenge is to nurture the cash cows and reverse the fortunes of the cash hog, either by closing down the franchise or replacing the franchisee, which should be decided on the basis of the profitability of the area itself.

The franchises should contribute to the franchisor's corporate performance objectives that include profit growth, above average return on investment, recognition as industry leader and enhancing shareholder value.

There should be a competitive and managerial resources fit that matches resource strengths to industry key success factors. The franchisor should have enough resource depth to support all businesses, and the benefits of transfer of resources and competitive capabilities must be apparent. Included in this must be the ability to forge stronger partnerships with key suppliers and agility in responding to shifting market trends

Spencer Gore Construction must have the facility to upgrade resources and capabilities to stay ahead of their rivals as there is depreciation when mimicry or retaliation occurs. The company must invest in acquiring new capabilities to maintain their leadership position.

Problematic areas include transfer of skills that can be difficult; much of the initial franchising process will be through trial and error as there is no blueprint available. Team building is critical, as all franchisees must have the same dedication, loyalty and hard working ethic that currently exist in Spencer Gore.

Close watch must be kept over the actions of rivals as it is very easy to misjudge their strength.

It must be borne in mind that throughout the development of the franchise business model the process is one of organisational learning and the original formula may be hard to replicate.

#### **5.7.6 Testing the Assumptions**

It must be borne in mind that certain assumptions carry enormous risk potential, even more so when the information available is limited and reliance has been placed on empirical evidence. The success of the franchise model relies heavily on management ability and the experience of the venture team. There is a strong dependence on key employees, and an estimated market growth of approximately 10-20%.

Cognisance must be made of the likely reaction of competitors and the technical feasibility of operating process, maintaining constant supervision over all projects, ensuring compliance with high standards and stringent quality control.

#### **5.8 Conclusion**

New moves need to be crafted to improve overall performance, and implementing the strategy needs to be based on building competencies, capabilities and strengths. A budget must be established, along with set policies and procedures. The organisation must be structured for optimal efficiency and effectiveness. A policy of best practices towards continuous improvement should be instituted, with the overall focus on improving product quality, speed and reliability. Supply chain management is a critical

## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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success factor and needs constant attention. Feedback from customers is constant and needs to be monitored.

Maintaining a loyal and motivated workforce is a key success factor and a system of rewards and incentives needs to be put in place. Most of all, a supportive work environment and a corporate culture of learning, leadership and focus on excellence needs to be instilled throughout the franchise operation.

According to Thompson Strickland (2003), strong leadership is essential as the leader needs to stay on top of events, closely monitor progress, ferret out issues, discover obstacles, promote the corporate culture and maintain the esprit de corps. He needs to mobilise and energise the workforce, be responsive to changing conditions and innovative ideas, have a high code of ethics and be a model corporate citizen.

The South African economic climate is currently very favourable, especially towards launching a franchising model in an industry such as building, where a larger portion of the informal building sector were disenfranchised under the previous regime.

Government has recognized franchising as a vehicle for empowering previously disadvantaged people and also for the potential employment opportunities offered by the business model. With government support and the support of financial institutions that also view franchising favourably, the opportunities are vast.

The franchise industry in South Africa is booming. It has achieved acceptance nationwide and the concept is understood and followed successfully throughout the economy. However, due to the untried nature of the proposed business model it is envisioned that some form of culture change would have to occur among potential franchisees in order for them to successfully fit the model. Independent small contractors struggling for survival have traditionally occupied the RA&A sector. While franchising may appear to be a viable option, the culture of shoddy workmanship and unreliability

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## A Study of Franchising as a Growth Strategy in the Residential Alterations and Additions Building Sector

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needs to be eradicated in franchisees in order to maintain and protect the brand name of Spencer Gore.

The methodology for franchising the model is somewhat different to the traditional model and as such, is based on a large percentage of trust and transparency on the part of the franchisor.

**APPENDIX A: SAMPLE OF CLIENT QUESTIONNAIRE**

Dear Homeowner

I am a final year MBA student at the University of Natal Graduate School of Business, doing my dissertation relating to the building industry, in particular customer expectations and satisfaction. In order to incentivise people to respond to the questionnaire my company is offering a lucky draw prize of R15 000 worth of alterations/additions of your choice. This competition is subject to the rules below.

It would be of enormous benefit if you would take the time to complete the attached questionnaire and either fax back to me on 031-562 9375 or post to PO Box 50698, Musgrave, 4062, whereupon your name will be entered in the draw.

Your cooperation is greatly appreciated. Should you have any queries at all you may contact me on 031-562 0676.

Many thanks

Catherine Goss

All personal information contained herein will remain the property of Spencer Gore Construction and will not be released to any third party.

**Competition Rules:**

1. Competition Closes on 15<sup>th</sup> June 2003
2. The draw will be done under the auspices of Stuart Edwards & Company (Chartered Accountants) and no correspondence will be entered into.
3. The winner's name will be announced in the Sunday Tribune dated 22<sup>nd</sup> June 2003
4. The competition is only open to house owners over the age of 21
5. The prize is not redeemable for cash
6. The value of the prize in the form of work to be undertaken will not exceed R15 000 including materials and labour, and the timing is subject to the discretion of Spencer Gore Construction
7. The prize is only redeemable for homeowners in the Ethekwini Municipal area
8. Entries may be posted to P O Box 50698, Musgrave, 4062 or faxed to 031-562 9375 or e-mailed to [support@sgc.co.za](mailto:support@sgc.co.za)

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**QUESTIONNAIRE**

1. What suburb do you live in? _____	
2. What is your joint monthly income?	<input type="checkbox"/> Under R5000 <input type="checkbox"/> R5000 - R9000 <input type="checkbox"/> R10000 - R19000 <input type="checkbox"/> R20000 - R29000 <input type="checkbox"/> R30000 - R39000 <input type="checkbox"/> R40000 - R50000 <input type="checkbox"/> Over R50000
3. What is your age group?	<input type="checkbox"/> 20 - 30 years <input type="checkbox"/> 31 - 40 years <input type="checkbox"/> 41 - 50 years <input type="checkbox"/> Over 50 years
4. Marital Status	<input type="checkbox"/> Single <input type="checkbox"/> Married <input type="checkbox"/> Divorced <input type="checkbox"/> Wfwd/Wfdower <input type="checkbox"/> Cohabiting
5. Number of Children	<input type="checkbox"/> 0 <input type="checkbox"/> 1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/> More than 3
6. Have you:	<input type="checkbox"/> Had alterations or additions done to your home? <input type="checkbox"/> Built a new house? <input type="checkbox"/> Are you planning to do any building work in the next year?
7. What was/will be the value of the work done?	<input type="checkbox"/> Less than R20 000 <input type="checkbox"/> Between R20 000 and R50 000 <input type="checkbox"/> Between R50 000 and R100 000 <input type="checkbox"/> Between R100 000 and R500 000 <input type="checkbox"/> Between R500 000 and R1million <input type="checkbox"/> Over R1million



8. How long ago did you use the services of a builder? <input type="checkbox"/> 0 - 12 months <input type="checkbox"/> 1 - 5 years <input type="checkbox"/> Over 5 years
9. How many quotes did/will you call for? <input type="checkbox"/> 1 quote <input type="checkbox"/> 1 - 3 quotes <input type="checkbox"/> More than 3 quotes
10. How did/will you find your builder? <input type="checkbox"/> Architect/Engineer referral <input type="checkbox"/> Newspaper advertisement <input type="checkbox"/> Friend/family referral <input type="checkbox"/> Builder's advertising board on site <input type="checkbox"/> Estate Agent <input type="checkbox"/> Yellow Pages <input type="checkbox"/> Regulatory Body (Master Builders Association, NHBRC) Other - Please elaborate: <input type="text"/>
11. How long do you think it should take for a builder to give you a quote? <input type="checkbox"/> Less than one week <input type="checkbox"/> 1 - 2 weeks <input type="checkbox"/> 2 - 4 weeks
12. How long after getting the quotes did/will you appoint a builder? <input type="checkbox"/> 1 week <input type="checkbox"/> 1 month <input type="checkbox"/> Over 1 month
13. What was/will be the main influence on your final selection of a builder? <input type="checkbox"/> Price <input type="checkbox"/> Previous client referrals <input type="checkbox"/> Friend/Architect/Engineer referral <input type="checkbox"/> Established builder in the area <input type="checkbox"/> Builder's guarantees/professionalism Other - Please elaborate: <input type="text"/>

14. Who made/will make the final decision regarding the builder? <input type="checkbox"/> Male head of house <input type="checkbox"/> Female head of house <input type="checkbox"/> Joint decision
15. Did your builder offer any warranties with his work? <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Don't know
16. Do you think the builder simplified the project with advice, suggestions, enhancements, doing additional work at no extra cost, etc? <input type="checkbox"/> None <input type="checkbox"/> Some value <input type="checkbox"/> Very helpful <input type="checkbox"/> Excellent service and assistance
17. Did the builder finish on time? <input type="checkbox"/> Finished before time <input type="checkbox"/> Finished on time <input type="checkbox"/> Was slightly late with completion <input type="checkbox"/> Was way over promised completion date
18. What was the level of tidiness on site? <input type="checkbox"/> Very untidy <input type="checkbox"/> Slightly untidy <input type="checkbox"/> Tidy <input type="checkbox"/> Very neat and orderly
19. What was the overall standard of the completed work? <input type="checkbox"/> I was very happy <input type="checkbox"/> A few problems that were quickly sorted out <input type="checkbox"/> Some problems that I ignored as they were not important <input type="checkbox"/> Many problems that were not sorted out <input type="checkbox"/> I am or was involved in a dispute with the builder to get problems solved

4

20. Would you use the same builder again?

Without hesitation       If I could not get someone else

Under no circumstances

21. Would you recommend the builder to anyone else?

Never       Only as acceptable       Yes - excellent

22. What builder did you use?

.....

**On a scale of 1 to 5 with 1 as not important and 5 as very important (mark scale with an "x"):**

23. How important was tidiness on site to you?

1      2      3      4      5

24. How important was the price of the contract to you?

1      2      3      4      5

25. How important was the quality of the finished building to you?

1      2      3      4      5

26. How important was the builder's advice to you?

1      2      3      4      5

27. How important was finishing on time to you?

1      2      3      4      5

5

28. How important was builder's previous client referrals to you?

1      2      3      4      5

29. How important was the professionalism of the builder to you?

1      2      3      4      5

30. How important was a quick response with the quote to you?

1      2      3      4      5

31. How important was it for the builder to be a member of a regulatory body (eg NHBRC, MBA, etc)?

1      2      3      4      5

In order for your name to be entered into our prize draw we require the following information:

Your Name: .....

Your Address: .....

..... Postal Code: .....

Your contact telephone number: .....

I agree to abide by the rules: Signature: .....

APPENDIX B: THANK YOU LETTER TO CLIENTS

**Spencer Gore Construction (Pty) Ltd**  
*Leaders in Lifestyle Design*

**SPENCER GORE**



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✉: P O Box 50698, Musgrave, 4062

✉: [cathyg@sgc.co.za](mailto:cathyg@sgc.co.za)

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29 August 2003

ANGELA WALKER  
31 LEWIS PLACE  
WOODLANDS  
4004

Dear Ms Walker

Thank you for taking the time to complete my questionnaire and return it. Your input is greatly valued and will be of immense benefit when I complete my dissertation.

Insofar as Spencer Gore Construction is concerned, we will put the insights gathered to good use in our constant striving to improve our client relationships and we are now in a far better position to design solutions that satisfy each client's unique needs.

Best of luck with the competition draw and, once again, thank you for your contribution. If we can be of any assistance to you in the future, please do not hesitate to give me a call.

Kind regards

Catherine Goss

**And the winner is...**

Spencer Gore Construction is pleased to announce that Merle Harvey is the lucky winner of R15000 worth of alterations to her home!

Many thanks to everyone who entered!

**SPENCER GORE**



**Phone:**  
**031-562 0676**

*Leaders in Lifestyle Design*

## APPENDIX D: SAMPLE OF QUESTIONNAIRE SENT TO LOCAL BUILDERS

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1) Is your company registered as a:

- C.C.
- (Pty) Limited
- Other (please specify)

If you selected other please specify:

2) Are you VAT registered?

- Yes
- No

3) Are you registered with NHBRC?

- Yes
- No

4) If yes, approximately what is the value of new houses built in the last twelve months

5) What is your average annual turnover in the alterations/additions sector of your business

- Under R100 000
- Between R100 000 - R250 000
- Between R250 000 - R500 000
- Between R500 000 - R1million
- R1million - R2million
- Over R2million

6) Do you have a formal office separate from your home?

- Yes
- No

7) Do you employ a full time secretary?

- Yes
- No

8) What office equipment do you have?

- Fax machine

- Photocopier
- More than one telephone line
- Computer
- E-mail

9) Is your main business telephone contact via cellphone?

- Yes
- No

10) How many work vehicles (trucks/bakkies) do you have?

- 0
- 1
- 2
- 3
- More than 3

11) Do you employ a full time foreman?

- Yes
- No

12) How many years has your company been in business for?

13) Do you believe you have the capacity to expand your operation if you could get more business?

14) What do you think is the biggest obstacle to your expanding your business

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This survey was created with [WebSurveyor](#)

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