The continued growth of franchising in Africa comes with its challenges

By Kendal H. Tyre and Pierce H. Han

According to the World Bank, the continent of Africa is home to six of the world’s fastest-growing economies.1 The International Monetary Fund projects that the economy of the African region will expand approximately 4.5 percent this year.2 Against this backdrop of growth, international franchises continue to expand into the continent because the region provides additional incentives to prospective franchisors beyond the economic growth rate: increasing middle-class with disposable incomes, positive political changes, increased foreign investments, low taxes and sales tax rates and increasing political and economic stability.3 However, this expansion into Africa has come with its own unique issues.

Last month, Starbucks entered into an agreement with Taste Holdings Ltd. to open the first sub-Saharan Starbucks in Johannesburg, South Africa, with additional locations to open shortly thereafter.4 Krispy Kreme Doughnuts announced earlier in May that they plan to open 31 stores in South Africa within the next five years.5 H & M Hennes & Mauritz AB plans to open its first H&M store in South Africa later this year; the company currently has at least two franchise locations in

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3 Id.
5 Id.
the continent. Domino’s Pizza has already opened 45 locations in South Africa since late last year. Other brands entering or already in the country include Pizza Hut, Gap and Zara.

The popularity and impact of the franchising industry in the African continent is self-evident. However, there are still many challenges.

**Intellectual property**

A basic understanding of any franchise arrangement is that the intellectual property of the franchisor is licensed to franchisees for a limited time and under certain terms and conditions. To protect its intellectual property, the franchisor reserves sweeping rights in its franchise agreements with its franchisees. The “rule of law” is critical to maintaining and protecting property. Without the franchisor’s ownership of its intellectual property, the franchisor would have no interest in teaching a potential competitor its proven trade secrets.

Concerns over the weak protection of intellectual property in Africa have been expressed by several brands, such as McDonald’s. McDonald’s is in countries such as Egypt, Algeria and South Africa, but Kenya, for example, for several years did not meet that particular franchisor’s market entry criteria regarding the protection of intellectual property. Moreover, examples of recent court decisions underscore the fact that intellectual property expertise varies in Africa.

**Capital**

Capital is another worry. Franchisors generally request franchisees commit over 50 percent of the total investment, but African banks are cautious lenders to SMEs and start-ups. However,

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8. *Id.*


10. In *Mega Power Centre CC t/a Talisman Plant and Tool Hire v. Talisman Franchise Operations (Pty) Ltd.*, a Namibian company, which was a franchisee of a South African company, provided large, “operator-intensive” tools and equipment to the Namibian building industry under the name “Talisman Tool Hire” for a number of years. When it discovered that a South African company intended to start a business with smaller, “non operator-intensive” tools under the name “Talisman Hire,” the Namibian company sued for “passing off.” Passing off is a common law action. To maintain a suit for passing off, the plaintiff does not need to have a trademark registration. Instead, the plaintiff must establish: (1) that it enjoys a reputation or goodwill in a name; (2) that the other party is, through the use of a similar name, misrepresenting that there is a connection with plaintiff’s business; and (3) that plaintiff is likely to suffer damages. The Namibian judge, relying heavily on South African law, determined that no passing off had occurred despite the strength of common law decisions in favor of the plaintiff and the strength of the *Talisman* name. This case emphasized the need for companies to register their marks in Africa. Had the plaintiff been able to rely on a registered trademark instead of a common law claim for “passing off,” the outcome would have likely been different. See Ilse Du Plessis, Edward Nathans Sonnenbergs, *South Africa: Namibian IP Case Highlights Pitfalls In Africa*, MONDAQ, July 29, 2013, available at http://www.mondaq.com/x/254536/Trademark/Namibian+IP+Case+Highlights+Pitfalls+In+Africa.

reforms in the African banking industry are changing the lending landscaping. Local banks in Kenya and South Africa now have franchise departments and are starting to look at franchising not as a business start-up, but as a support system for business enterprises that may merit a closer inspection.12

Another initiative addressing the financing concerns of franchisees is the Franchise Fund, originally launched in 2014 and backed by the Development Bank of Southern Africa.13 It is aimed at young and disadvantaged entrepreneurs with limited access to capital and assets to qualify as franchisees. Franchisee applicants are required to undergo a thorough screening process and complete a formal training program.14 In addition, the franchisee must provide a minimum contribution of ten percent of the total financing requested.15 Only those franchisors that are members of the Franchise Association of South Africa and comply with certain other minimum requirements can participate in the Franchise Fund program.16 The Franchise Fund has been allocated 107 million rand [approximately US $7.9 million]—comprised of 48.65 million rand (approximately US $3.6 million) from South Africa’s National Treasury’s Jobs Fund (38.92 million rand allocated for financing and 9.73 million rand allocated for technical assistance) and 58.38 million rand (approximately US $4.3 million) from Business Partners Limited, a specialist risk finance company for SMEs in South Africa.17

Supply chain
Supply chain issues present yet another challenge. Although much of the franchise activity is present in South Africa, many international franchisors have used the country as a springboard into the rest of the region and continent, including Namibia, Zambia and Botswana.18 Many of these franchisors have developed “integrated strategies” for expansion such as acquiring their own local logistics and supply chain businesses to ensure control over the supply chain and to provide consistent customer experience.19

Many other sub-Saharan African countries are still in the early stages of supply chain development and this may cause problems for some franchisors.20 African franchisees are required to maintain adequate supplies of the products that fuel their businesses and those products must also meet the franchisor’s particular quality standards. For example, KFC and other fast food brands require adequate supplies of chicken that meet their standards.21 This may be difficult in certain African

12 Rundell, supra note 9.
13 CNBC Africa, supra note 11.
14 Id.
15 Id.
16 Id.
17 Id.
19 Id.
countries where the supply of chickens from local chicken farmers fails to meet the franchisor’s criteria for not only food safety and security but also quality and quantity. For example, South African KFCs sell almost 10 percent of the nation’s commercially grown chickens. In these instances, local franchisees are required to purchase their supply from outside the country from franchisor-approved suppliers. To ensure adequate supply needs are met and to cut costs, some franchisees are working with their franchisees to secure local suppliers.

Franchising in Africa is not without its challenges. Whether faced with weak intellectual property protection, a lack of franchisee capital or shortcomings in the supply chain, it is imperative that prospective franchisors and franchisees perform a thorough due diligence on the legal and business environment before proceeding into a franchise relationship to ensure a successful arrangement.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

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Parts of this alert were based on excerpts from Franchising in Africa 2014: Legal and Business Considerations, a book edited by Kendal H. Tyre and Diana V. Vilmenay-Hammond. This 400-page book reflects the work of more than 30 experts in the field. It is the first in a series of books on international franchising published by LexNoir Foundation. The second book in the series is Franchising in Asia 2015: Legal and Business Considerations.

Click here to view a video book trailer of the publication—Franchising in Africa 2014.

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22 Id.
23 Id.
25 Id.