Research Paper Commerce

Retailing Business Model - Franchising

Ms. N. Ramya

Assistant Professor, Department of Commerce with Professional Accounting, Dr. N. G. P. Arts and Science College, Coimbatore – 641043

KEYWORDS

What is Franchising?
Franchising in general means granting of certain rights by one party (the franchisor) to another (the franchisee) in return for a sum of money. The franchisee then exercises those rights under the guidance of the franchisor.

The International Franchise Association (IFA) defines franchising as a "continuing relationship in which the franchisor provides licensed privilege to do business, plus assistance in organizing, training, merchandising and management in return for a consideration from the franchisee".

Who is a Franchisor?
He is the owner of the franchised system. It owns the know-how of the concept and the brand name. It grants franchises to third parties.

Who is the Franchisee?
He is the one who has been granted the right by the franchisor to carry on the business using the franchisor's know-how and the brand name. Now, depending on the rights granted, franchisee's can be classified into:

Unit Franchisee – this is the simplest and most common form of franchising. This franchisee is granted the right to operate one unit or outlet of the franchised business.

Master Franchisee – He is generally granted the right to a substantial territory. It will then grant unit franchises to unit franchisees throughout the territory. The Master Franchisee needs to have sufficient drive and resource to fully exploit the territory and control the unit franchisees territory.

Regional Franchisee – In a geographically large area a franchisor, or a Master Franchisee may decide that it is commercially appropriate to further divide the territory up with separate regions and grant a Master Franchise for each separate region. These franchises are known as regional franchises or sometimes area franchises.

Multiple Franchises – Some unit franchisees operate not just one unit, but several. These are referred to as multiple franchises and usually have a large number of individual unit franchise arrangements – one for each unit.

Developers – Large Corporations sometimes prefer to exploit their territory by opening outlets themselves. These are known as developers. They have a single developer agreement, which allows them to open many units. These are pilot operations so that they become fully familiar with the business at an operational level and can localize it so as to improve its chances of success.

Basic Elements of Franchising
An entrepreneur (franchisor) has developed a system of doing business, which works and decides to grant the rights to another entrepreneur (franchisee) to use the system.

The two entrepreneurs are legally and financially independent enterprises.

The granting of the right to use the franchise system involves the right of the franchisee to use the franchisor's intellectual and industrial property, know-how, business and technical methods, procedural system and other intellectual property rights.

The franchisee in exchange undertakes to follow the methods elaborated by the franchisor and to pay an entrance fee and / or royalties.

The franchisor retains the right of control over the performance of the franchise.

The franchisor undertakes to provide the franchisee with training and on-going assistance.

The four 'R's of Franchising
Franchising can succeed if the franchisee has a right combination of the four R's prescribed.

1. **Realism** – The franchisee should be very realistic in assessment of his business strengths and weaknesses. Certain key areas where realism is a must while deciding to go into franchising includes questions like are you prepared for the financial insecurity? Are you capable of developing a frame of mind? When you can smile and be cordial even when the customer is totally wrong? More important is the need for realism in evaluating the products and services offered by the franchisor.

2. **Resources** – Many franchisees, during the early periods of their business when resources constraints are common, tend to sometimes overlook sending in the royalty cheques to the franchisor. Franchisor keep feeling and rightly so that their royalty is as much a key business expenditure of the franchisee as payment for purchases or payroll is any delay in handling this area would lead to unfortunate consequences of a long term nature. Therefore, while planning resources on a periodic basis, consider the payments that are to be made to franchisor. Another area where most franchisees have problems is to manage their resources while living within the franchising system. The franchising agreement, in most cases, clearly indicates systems, procedures and methods of managing the resources. The franchisee will do well to either be mentally prepared to accept the resource management terms of the franchisor or make it clear at the beginning that he needs the requisite leeway to manage his own resources.

3. **Research** – Research on the franchisor is a must for the success. Various published sources also provide fairly detailed information on most of the franchises that are on offer but to

what extent that will suffice for the Indian conditions needs serious examination. Whatever be the methodology, the prospective franchisee will do well to build comprehensive information on the franchisor, the products or service of offer, competing and substitute products and services before he makes any move committing his financial resources on a long term basis.

4. **Resolve** – Resolve to be part of the franchising system. The problem starts when a person gets into franchising only because he has an entrepreneurial instinct but the instant he becomes a franchisee, the true entrepreneur in him starts resenting the shackles that are imposed by the franchising system. The options are clear – either stays within the system and fully learns the nuances of the business and prosper or try one's fledging entrepreneurial talent and get into trouble.

Modes of Franchising

Direct Franchising – Under this system, the franchisor grants franchises to individual franchisees in the foreign country through the execution of an international contract. The main problems associated with this type of franchising is the difficulty of franchisors to control the performance of the franchisees as these are located in another country, the assistance to be provided to the franchisee during the operation of the contract. The question of intellectual and industrial property rights in the foreign country also needs to be considered. Taxation is another issue which receives due consideration. Furthermore, how the franchise arrangement is structured and the existence of treaties between the countries involved may have considerable influence on taxation. A very important question is clearly that of the choice of law and jurisdiction. There is a tendency for franchisors to want their own domestic law to apply to the agreement, even if the franchise is exploited in another country. Another vital point to be kept in mind is the law relating to transfer of technology that may be applicable. Keeping the above problems in mind, it is observed that direct franchising is not used extensively internationally.

Subsidiary or Branch Office – Franchising through a subsidiary or a branch office are two methods which are often treated together, although there are differences which derive from the fact that a subsidiary, albeit controlled by the franchisor, is a separate legal entity whereas a branch office is not. Whatever be the difference, an advantage of this approach is that the franchisor is present in the foreign country as a corporate body. The contract will in this case be a domestic contract and thus subject to local legislation. The problems associated with this type are similar to direct franchising. In addition, the franchisor will be required to send his personnel to the foreign country for the startup operations thus involving work permit and residence formalities.

Area Development Agreements – Such agreements traditionally involved an arrangement whereby the developer is given the right to open a multiple number of outlets to a predetermined schedule and within a given area. These arrangements in the past have been used mostly in domestic franchising, but are now being used increasingly in international franchising. Items that are to be considered here include the number and density of the outlets to be opened, detailed development schedule and the consequence of non-complying of the schedule. In such arrangements, the developer will need to have substantial financial resources so as to be able to open the required number of outlets.

Master Franchise Agreements – In the international scenario, this is widely used. In respect to such agreements, the franchisor grants a person in another country, the sub-franchisor, the exclusive right within a certain territory to open franchise outlets itself and/or to grant franchises to sub-franchisees. In this case, there are two agreements involved: an international agreement between the franchisor and the sub-franchisor (the master franchise agreement) and a national franchise agreement between the sub-franchisor and each of the sub-franchisees (the sub-franchise agreement). The franchisor transmits all its rights and duties to the sub-franchisor, who will be in charge of the enforcement of the sub-franchise agreement and of the general development and working of the network in that country. All the franchisor will be able to do is to sue the sub-franchisor in case of breach of obligation to enforce the sub-franchise agreement as laid down in the master franchise agreement. The advantages of this system are that the sub-franchisor is familiar with the local habits, tastes, culture and laws of its country and that it will know ways about the local bureaucracy for necessary permits as and when necessary. The disadvantages include that the financial returns of the franchisor will be reduced by the amount due to the sub-franchisor and also that the franchisor will have to rely on the sub-franchisor for the performance of the franchise system.

Joint Ventures – In the case of joint ventures, the franchisor and a local partner create a joint venture. This venture then enters into a master franchise agreement with the franchisor, and proceeds to open franchise outlets and to grant sub-franchises just as a normal sub-franchisor would do. An arrangement such as this will have to consider legislation on joint ventures in addition to all the other legalities that are involved. Problems may also arise with the fact that the double link may create conflicts of interest for the franchisor. The advantages accruing from this arrangement may include that it could be a way to solve the problem of financing franchise operations in countries where financial means are scarce.

Miscellaneous forms – There is no limit to the refinement that can be made to the above forms of franchising to accommodate the differing demands of potential franchisor and / or franchisee. New forms of franchising, or combinations of different forms of franchising, appear at regular intervals. Examples of these are stated as follows:

Multi-unit Franchising
Affiliation or conversion Franchising
Franchise within a Franchise
Subordinated Equity Arrangements
Management Agreement
Franchise Buy-ins

FRANCHISING IN INDIA

How is franchising relevant to India?

Franchising affords India an opportunity to build its commercial infrastructure and develop its domestically oriented businesses in an efficient, profitable and pan-national manner. It also offers India the opportunity to import and develop foreign concepts in a way, which ensures that the equity of the business remains in India, so avoiding the politically undesirable situation whereby successful domestic businesses are owned by foreign corporations.

The key attractions of franchising in India

1. **Lower Capital Requirements** – Franchising is an excellent way for both Indian and foreign corporations to expand their businesses and make their brand names known in India without having to risk large sums of money by way of direct investment. The franchisees finance the expansion of the business in India. In return they have the opportunity to make substantial income and capital profits.

2. **Geographical Extent of the Country** – Franchising can enable a company to take advantage of the vast Indian market of over 1000 million people and growing at a rate of 1.9% p.a. There is an ever-growing demand of goods and services such as fast food and beverages, clothing, electronic goods, computer hardware and software and professional services. The infrastructure is poor, however, and operating a corporately owned distribution system that fully exploits the geographical expansion of the country is extremely difficult and inefficient. Empowering participants in the distribution system by granting them an equity interest in it (i.e. by granting a franchise) can substantially improve the efficiency in the distribution system.

3. **Cultural Empathy** – Franchising well suits the entrepreneurial side of Indian culture. Indian business people are fiercely proprietary and feel a need to have ownership and control over their business operations which they can pass on to future generations. However, at the same time they are keen to benefit from the goodwill and technology that can be provided by the foreign franchisor. Franchising allows them to reconcile these conflicting ambitions.

4. **Harnessing local market knowledge** – Indian master franchisees offer the foreign franchisors direct access to substantial market knowledge and a considered and sophisticated approach to its exploitation. A company needs a great deal of knowledge of the different regional markets in India. What holds good for Punjab may not be relevant for Kerala. Franchising provides a sure and easy way of accessing the right level of relevant local market knowledge.

Advantages and Disadvantages of Franchising for Indian Businesses

Advantages to the Franchisee
- He is the proprietor of its own business and owns the tangible assets of the franchised outlet.
- He gains from the franchisor the entire business concept with full training, assistance in every aspect of setting up and running the business, and access to necessary materials and supplies.
- Franchisees have access to regional and national promotions / advertising campaigns.
- He gets an access to global standards and international technology in products and services, without loss of control.

Disadvantages to the Franchisee
He is not an independent entrepreneur. He has to follow the franchisor's instructions.

The lower risk is offset by the lower reward for the success.

Advantages to the Franchisor
- Franchising allows him to increase its number of outlets with minimum capital outlay and so accelerate the network's growth and probably it's profitably.
- Self-employed franchisees are generally more motivated than salaried managers and are more likely to give better results for less expenditure of capital on behalf of the franchisor.
- Franchising provides him an opportunity to have access to international market.
- Franchising gives him an assured earnings stream to fund continuous Research and Development investment.

Disadvantages to the Franchisor: -
It has to control and co-ordinate a network of semi-independent entrepreneurs to ensure favorable image of the franchise.

The franchisor-franchisee relationship is based on trust.

Franchising in India so far
Franchising in India is at its early stage and neither business people nor the courts have had much exposure to it. Soft drinks and hotel franchises arrived in India in the 1960's, but in the 1970's and 1980's, the government expelled foreign brands from India.

Some international franchises have recently come back to India and are doing well. Hotel businesses like Best Western Group and the Quality Inn Group have established themselves. Also, Walt Disney has been successful in having its label in all sorts of goods for children, whether they are clothing, toys, and school equipment's. Fast food chains like McDonalds, Slice of Italy, Dominos, and Taco Bell have also come in. Pepsi and Coke have re-captured the soft drinks market.

A lot of local franchises have also become established. Examples are:
Nilgiris – food retailing chain in the south and currently has 10 franchised stores.

Pizza Corner – Chain of dine-in restaurants and delivery outlets. Plans to open another 100 franchised outlets over the next 5 years.

Aptech – computer-training business which has some 950 franchised centers.

Blue Dart- a courier company with some 840 franchised outlets throughout India.

CONCLUSION
Finally, to conclude there are divergent views on the future of franchising. Some experts are of the opinion that the giant, big brand retailers would dominate the small ones due to their wider investment capacities. It would be next to impossible for the small retailers and the kiranas to prove their existence in the battlefield of franchise retailing. In this intricate business world, the franchising will become tremendous business model, and it may be very helpful and most profitable method of business process in coming decade.

REFERENCES

http://www.ifa.org | http://www.wfa.org | http://www.fai.org | McDonald's application of marketing mix. Retrieved on January 20, 2005, from http://www.bized.ac.uk/compfact/mcdonalds/mc25.htm. | http://www.kaizencoaching.com.au/articles/basics_marketing_PLC.htm. | http://www.scribd.com/doc/11520753/Marketing-strategies