

Franchising: A Proven Business Expansion Model

By Jason Soon



Franchising involves licensing one's trade mark and operating system to another business partner to expand their business.

Franchising is often misunderstood as a route to achieving business success overnight. Though it is a proven model for expanding a business, there are risks to consider on both sides of the equation—the franchisor and the franchisee. This article examines some of the strategies, benefits, and drawbacks of franchising.

the numbers of local franchises have been steadily growing including the likes of Old Chang Kee, Osim, and Fish & Company.

Franchising is both entrepreneurial and embarking on a tried-and-tested path. If a business owner has discovered a successful formula and wants to expand without having to run those businesses himself, he can co-opt the help of others. This is done by licensing the person he appoints to run an additional store. That person, known as the franchisee, will then pay royalties as a percentage of total sales to the owner in order to continue operating.

The business owner will reap profits and enhancements to his brand and reputation with the addition of a new store, while the franchisee, will embark on a hopefully money-making enterprise which had proven to be profitable.

At the core of franchising is the exploration of a new business venture with a partner. The exploration of a business opportunity constitutes

ACCORDING to a 2008 United States Commercial Service market report, the total sales turnover of franchises in Singapore is US\$5.48 billion in 2005, accounting for 18 per cent of total domestic retail sales. A significant portion, 70 per cent of the sales is accounted for by foreign franchises, but



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operating through times of uncertainty, requiring high levels of resilience, in addition to excellent leadership qualities, and incredible flexibility to successfully deal with the ambiguities and changing circumstances and navigate to success.

In *Franchising: Pathway to Wealth Creation*, Stephen Spinelli, Robert Rosenberg, and Sue Birley emphasised franchising as a way of enhancing your own wealth and branding by leveraging on others' innovativeness and entrepreneurship. The franchise opportunity ultimately boils down to an entrepreneurial process, which they described as "the process of constantly evaluating and shaping the opportunity—and subsequently balancing the human, financial, and physical resource requirements that are needed for the venture to begin, launch, grow, and succeed".

Albert Kong, chief executive officer, CEO, of Asia-wide Franchise Consultants Pte Ltd, has been in the franchise consulting business for 20 years. His company has helped with more than 400 companies in Asia and helped them to develop their business concepts and expand their businesses. Kong pointed out that though franchising is an effective model for expansion, a lot of things that apply to any business will also apply to franchising. He stressed the four Ps of the marketing mix: product, price, place, and promotion.

Product refers to the quality criterion, and whether the goods or service is what customers want. Depending on the particular market context, the product range and the product's appearance are also important aspects. Price must be set right so that consumers are willing to buy the goods or services. Sometimes luxury goods need a high price tag to reflect its status-conferring properties. Place refers to the logistical aspects of the business including distribution, storage, and transport, it is sometimes where the product can be purchased. Promotion covers everything from the design to

the communication media used to build up brand recognition and raise awareness of the product.

One has to ensure these elements are already in place before venturing into any market. Experts from academia and other sectors may point to other Ps which are important considerations such as people or physical evidence. Kong says: "It is very clear to us that at the end of the day, there is no magic formula; your basics must be in place; your product or service must be what people want, or you know how to make people want it; your pricing must be right; you must have enough distribution points, even in advertisement, you must know how to use the right media, and if you engage the wrong consultancy or advertising agency it can backfire and cause problems."

There are at least two types of franchise arrangements. A franchisor can either grant a single-unit franchise, where the franchisee has rights to open and operate only one franchise unit, or multi-unit franchise, where the franchisor grants the rights to operate more than one unit.

Some key features of a franchise include a proven concept, economies of scale when purchasing supplies, and expanding without using one's own capital. However, there are risks associated with franchising, and one should not see it as something out of the ordinary. Kong has seen many examples of successful franchises, but he noted that are quite a number of failures.

The International Franchise Association, IFA, recommends prospective franchisees to do extensive research and thorough investigation on the potential franchise before making their purchase decision. Some questions one might want to find answers to include the track record of the franchisor, what kind of training and support will

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be provided, how the other franchisees in the same system are doing, the franchisor's expansion plans, and whether you can afford it.

You would not be able to get through the door of some franchisors if you do not possess

the requisite background or qualities. For example, Spinelli, Rosenberg, and Birley reported that Dunkin' Donut conducts extensive personality profiling of potential franchisees to ensure the skill set and enthusiasm of the entrepreneur is compatible with their franchise demands.

Kong strongly reinforces this point: "If you have chosen the right franchisee, the motivation of the franchisee itself is a very powerful force. Because the franchisee will turn up, whether rain or shine, and they will put in their best vis-à-vis employing one's own staff who might call in sick over the silliest things for example flooding, quarrel with girlfriend, et cetera."

Ho Khai Weng, franchise sales manager of Subway Systems Singapore Pte Ltd says: "Subway has a qualification process to determine if an applicant is a right fit for the franchise. This process also serves to manage the expectations of the applicant, improves the applicant's understanding of the franchise, and the type of support that the applicant can rely on."

IFA recommends a thorough self-examination of one's abilities, interests, and business skills to see if they fit the requirements. Kong likens what his company does for potential franchisees and franchisors to a soul-searching exercise: "In the many lectures I've given around the world, 30 over countries plus the polytechnics, National University of Singapore, and Nanyang Technological University, normally I will tell the audience, 'always get your basics right.' So you put yourself in the shoes of the other person, who is going to be your franchisee, why would he want to take up your concept be it cleaning, childcare, gelato, cakes, or information technology, IT, training. [If you are the franchisee] are you going to continue to make it strong? How passionate are you?" His business' role is that of "perfecting" the clients' business or making it a little more solid first, and if they are imperfect, he will try to replicate the successful aspects of their business.

Franchisee-Franchisor Problems

Kong says: "Franchising is very much a team-work kind of thing. Even if you are very good, but



Frequent, open, and informal communication is key to sustaining the franchisor-franchisee relationship.

if you have chosen bad franchisees, they can kill your brand. But conversely if you recruit very good franchisees, these are the people who will give you new ideas, who will come up with improvements, to strengthen your business."

An inevitable occurrence of close relationships is conflict. Entrepreneurs must successfully wade through the human relations ballgame to achieve their goal of creating wealth. Some of the disputes that may occur in a franchisor-franchisee relation include differing opinions on products and services offered, the way the brand is developed, the execution of marketing campaigns, and the type of support given.

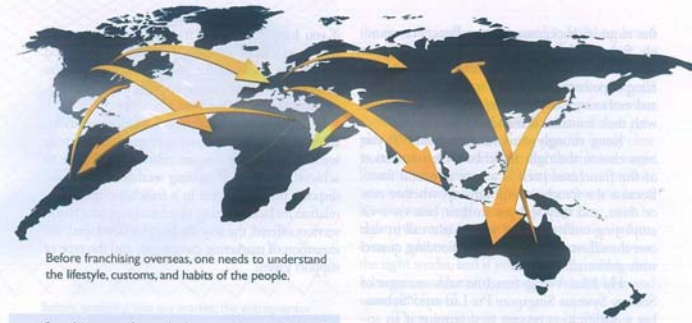
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According to Spinelli, Rosenberg, and Birley, almost 50 per cent of all franchisors are in a lawsuit at any given time, and 30 per cent of franchisees are unhappy enough to consider severing the franchise relationship. Because operating a franchise means an intimate business relationship, it is not uncommon for franchisees to put the blame on the franchisor when things go wrong.

However, such problems can be managed with frequent, informal, and open communication through turbulent times. Ho said: "There is no magic formula; it's down to communication. One thing that we pride ourselves about the system is communication. We send out newsletters on a regular basis, from HQ, from the regional offices and in some cases, even our development agents send out newsletters."

Franchisees can also fail to fulfil their end of the agreement through a variety of mechanisms. For example, they may misrepresent their profit margins to evade paying huge royalty fees, use a lower grade material to produce their goods, or refuse to spend the required amount of money on local advertising.

In light of these potential issues, a variety of mechanisms for monitoring franchisee operations is called for. They include using field service personnel to monitor quality, employing external auditors, using a system of peer review, using analytical tools including the electronic point-of-sale system, and surveying customers. Through such channels, the franchisor can track the performance of individual



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franchisees and watch for any abnormalities that warrant further attention.

The inadvertent disadvantages of a franchise pour harsh reality on the spirit of enterprise. But spinoffs of the well-oiled system are just as powerful and exhilarating. Franchisees and franchisors who set up a franchise advisory council, FAC, or other information sharing system can benefit from innovations implemented at other outlets, learn solutions to problems, or adopt other methods of cost-saving.

The national advertising fund normally administered by the franchisor, in which franchisees contribute a proportion of sales for marketing and promotions on a national level, can lift the brand recognition of franchisees to high levels. This is because advertising on such a massive scale sends signals of strength and power to a larger and wider audience, significantly raising consumer confidence.

Franchising Overseas

Singapore's multiracial and English-speaking society makes it an ideal place to test out franchise concepts. In addition, there are no oppressive laws to franchising. Kong cited its strategic location, good infrastructure, and business-friendly government as key factors in making it an attractive location, and a lot of foreign franchisees have decided to set up their regional headquarters here.

According to the United States Commercial Service, Singapore is the "gateway to Southeast Asia" because of its multi-ethnic society, and foreign companies can gauge the marketability of their products based on the local's reactions. It is home to more than 420 local and foreign franchise concepts.

Several domestic franchisees which have been successful overseas include BreadTalk, Ya Kun Kaya Toast, Charles & Keith, and Crystal Jade My Bread. But venturing into another country to explore the viability of a franchise concept is not as easy as it looks.

According to Spinelli, Rosenberg, and Birley,

several important items need to be investigated. They include:

- Legal and regulatory environment for franchising,
- Import rules and customs,
- Taxation structure,
- Cost and availability of labour,
- Purchasing power of the population,
- Economic and political stability of the country,
- What franchisees currently operating there are saying,
- Language barriers, and
- Cultural differences.

One might want to explore the services of embassies overseas or proven consultants who might conduct primary market research or search for potential franchisees for a fee.

According to Kong, it is important to do one's homework and get a better understanding of the people and culture when trying to go into business. One has to take into consideration the lifestyle, habits, and customs. Sometimes, the nature of the business itself plays an important role. He gave the example of rainforest cafe, an American franchise which did not find acceptance among Singaporeans. This is because even though westerners found the jungle ambience to be cute, the locals who may have done National Service found it dull and boring.

He recommends using the PEST analysis. It refers to examining the specific country's political, economic, social, and technological landscape. This will help the entrepreneur better position himself, and avoid making mistakes that others may have committed before.

The enthusiasm of a motivated entrepreneur is important to exploiting ambitious opportunities. But just as important is the willingness to do hard work. Both a sense of adventure and a complete understanding of the risks involved are essential to carving out success in franchising.