

VIABILITY OF FRANCHISING BUSINESS MODELS: AN EMPIRICAL STUDY

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ABSTRACT: *Franchising is an arrangement where one party (franchiser) grants another party (franchisee) the right to use its trademark or trade-name as well as certain business systems and processes, to produce and market a good or service according to certain specifications.*

The franchisee usually pays a one-time franchise fee plus a percentage of sales revenue as royalty, and gains immediate name recognition, tried and tested products, standard building design and decor, detailed techniques in running and promoting the business, training of employees and ongoing help in promoting and upgrading of the products.

For examples some of the largest franchise in the world which are deemed as supersized franchise brands are McDonald's, 7-Eleven, KFC, Subway, Burger King, Hertz, Ace Hardware and Circle K.

Until now, research on franchising has been lacking in India. However, India was one of the first Asian countries to develop numerous franchise units. Previous franchising research indicates that qualitative studies are not sufficiently used in this field. Therefore, it was decided to interview franchisees in order to better understand how and why people choose franchise rather than other forms of business.

The purpose of this exploratory/descriptive quantitative study is to examine the viability of various franchisee models prevailing in the market. For this research the researcher has selected a sample size in the city of Chennai.

KEY WORDS: Franchising, Business, Brands, Franchiser, Franchisee, Marketing, Advertisement.

JEL CLASSIFICATION: C12, C21, C42, L10, L85.

1. INTRODUCTION

We can see that although Franchising is in its nascent stage, franchising is gaining wide popularity in all the segments especially in Retail, POS and Exclusive Outlets in India. The prominent segments they are spread are like areas of QSRs, Technical Domains like Cartridge Refilling, Car Care, Restaurant Chains, Consumer Goods and Computer Training Centers.

Definition of Franchising:

In a nutshell, franchising is a business system where under the franchisor grants a license to the franchisee to use the franchisor's diverse intellectual property rights, namely know-how, designs, brands, trademarks, patents, and trade secrets along with the franchisor's proven name, reputation and marketing techniques to market the franchisor's products or services in return for a sum of money.

Different types of Franchising:

Single-Unit Franchise

In a single-unit franchise system, one person buys a store from the main company called as a franchisor and operates it according to the company's rules systems and processes.

Master Franchise

The master franchise is a popular way to expand the franchisee spread to larger geographical area like State wide, Country as whole or even international boundaries. Master franchisors often establish smaller unit franchisees and control them as franchisor.

Trends in Franchising in India:

The discussion begins with the overall franchising trends in India, what were some of the key growth drivers, how many franchisors and franchisees are operating sector segment wise, how much of it was organized versus unorganized.

Also the proportion of total revenues of each of these segments contributing, sector wise. It is obviously clear and certainly believed that food, retail; education and services formed the core of Indian franchising. The rising entrepreneurial spirit in the country, coupled with the huge consumer class, availability of investment capital.

2. IS INDIA CONFIGURED CULTURALLY AND DEMOGRAPHICALLY FOR FRANCHISING SUCCESS?

Franchising in India is more successful now than ever before because companies have begun understanding that selling a franchisee is just not sufficient, supporting them and ensuring that they carry forward the delivery of the product/service in the way it is defined, is crucial for its success.

When the researcher began to probe 15 years ago in the field of Franchising, the researcher found a lot of franchise companies failing, but now the failure rate has come down

considerably. The failure he could see clearly was attributed to not understanding the far reaching effects of franchising not the franchise model itself as is generally the misconception.

Advantages of Franchising for Franchisor and Franchisee:

- ❖ A franchise provides an established product or service which may already enjoy widespread brand-name recognition.
- ❖ One gets the important benefits of a pre-sold customer base which would ordinarily takes years to establish.
- ❖ Franchises usually offers pre-opening support like site selection, interior design, training and a grand-opening program.
- ❖ Financing the business may be easier. Banks are sometimes more likely to lend money to a franchise with a good reputation.
- ❖ Risk is reduced and is shared by the franchisor.
- ❖ Finding an investor, who is willing to invest in a business venture of a novice, is quite difficult. But with franchising, should not be major problem as the goodwill of the franchisor acts as guarantee.
- ❖ The bulk purchasing power of a franchise system ensures that you get discounts from manufacturers.

Disadvantages of Franchising for Franchisor and Franchisee:

- ❖ Investment shall be way higher than predicted. As well as the initial costs of buying the franchise, continuous royalty payouts and you may have to agree to buy products from the franchisor.
- ❖ The franchise agreement usually includes restrictions on how you run the business. You might not be able to make changes to suit your local market.
- ❖ The franchisor might go out of business, or change the way they do things. Other franchisees could give the brand a bad reputation.
- ❖ You may find it difficult to sell your franchise – you can only sell it to someone approved by the franchisor.
- ❖ Reduced risk means you might not generate vast profits.
- ❖ You may suffer loss, if another franchisee somehow gets entangled in bad publicity. Like the proverbial “rotten apple”, it can damage the whole chain.
- ❖ Your franchisor may force you to buy products from suppliers at higher prices than the market-rate.
- ❖ The public image of your business can be damaged if other franchisees are performing poorly or the franchisor encounters problems.

3. FRANCHISING CHALLENGES IN INDIA

India as the environment is conducive and favorable for growth of franchising; there are also many challenges for its expansion. How difficult is it for franchisors to convince franchisees of business viability, returns and the brand and its quality; for the researcher all these 3 things are co-related. It is extremely difficult to make the first few franchises.

Once you make these franchises; their success then moves your franchising system from tier 1 to tier 2. Having a proper franchise marketing strategy which is focused not at getting the desired numbers but equally focused on getting the right profiles is critical for most franchisors to succeed and this is where most of them fail.

Expensive Real Estate: In the metropolitan centres of India, retail space continues to be extremely expensive. Resistance on Fees and Royalty Payments: Indian potential franchisees believe that the franchise/royalty payments are high.

Lack of Legal Framework: India does not have a comprehensive franchise law to regulate this industry sector.

4. THE AIMS AND OBJECTIVES OF THE PRESENT RESEARCH

- a) To study various franchisee models currently prevailing in the market of the sample size selected for study.
- b) To personally meet the actual franchisee owners and collect primary data for analysis. To analyze the findings to generate expected outcomes.
- c) To check the success and failure factors for the franchisee.
- d) To generate a First of its kind “Franchise Buying Guide – A Handy Work Book” for the layman who aspires to buy a new franchisee.

5. REVIEW OF LITERATURE

Frazer (2002) who conducted a confidential mail survey of the known population of Australian franchisers. As no official listing of franchisers was available, resulting in a sample of 946 firms was assumed to be operating franchisees. The mail survey was followed up with a letter and telephone call where the status of each firm was ascertained. After excluding those not involved in franchising the effective sample size were 693 franchisers. A total of 186 useable responses were received, representing a response rate of 26.8 percent which is within the acceptable range for business research (Neuman, 1994).

Paynter (2002) conducted a survey on Determinations for Franchisee success and Franchisee Satisfaction Parameters in Auckland, New Zealand. The survey was set up as an international study with twelve participating nations. Using this approach it was found that the 53 franchisees business results were abnormal. They did not receive value for the marketing levy and were struggling to break even.

Marya (2012) in his Annual Report on Franchisee 2012 has said that Indian Franchisee Industry has faced many challenges in past and many more challenges are still prevalent in today's scenario. He briefs:

- a) Correct approach to fight the Indian Diversity.
- b) Soaring Real Estate Prices.
- c) Belief that free sand Royalty payments are very high.
- d) Requirement of a strong legal Framework.

India being a vast country with diversity in many ways it poses beneficial in many ways but also poses a challenge due to legislative gaps that surrounds the franchisee business environment. The franchisee horizon in India seems positive and robust for growth. After a detailed business analysis sector wise that will guarantee business success to the investors as well as ride the industry growth average to greater heights. Beesley (2013) has published in her paper about Credit Crunch that Franchise Industry has faced during 2008. She says that financing remains a problem for potential franchise owners. According to Entrepreneur magazine (January 2013), there's still an 18 percent lending shortfall in the franchising industry.

In a bid to boost franchise ownership, many franchisors are taking matters into their own hands and offering financing programs of their own. Meineke, The UPS Store, Gold's Gym, Massage Envy and Instant Imprints are just a few examples of franchisors now offering financing to qualifying first-time and multi-store franchise owners.

6. RESEARCH METHODOLOGY

Researcher has tried to study the Franchisee models under Technical Domain with investment are below 50 Lacs. These are IT or ITes related, Product Related, Computer Training Institutes and Technical Category.

The available data of Franchisees which were at one time operational and designated as Unit or Master Franchisees was N=146. This Franchisee data is correct and rechecked from market survey and franchisor websites/ market research reports. Researcher has tried to contact all of them but out of 146 we could only reach n=55 franchisees who agreed to meet us, fill our questionnaire, answer our questions over telephonic interviews, personal interviews, repeated visits, etc.

7. SAMPLE STUDY BEARS THE FOLLOWING CHARACTERISTICS:

- a) Different category of franchisee business was targeted like Inter Cyber Care Business, City Centre Plaza, Express Avenue, Spencer Plaza, Ampha Skywalk Mall, Cartridge Refilling, Computer Training Institutes, Car Care, etc.
- b) The nature of firms includes both Master Franchisees and Unit Franchisees. Region of Chennai City was only considered for survey.
- c) They gave valid information required for the questionnaire for analysis and study. The researcher's friends by profession was into franchisee business jobs for past 10-12 years and they themselves has experienced more than 75+ Franchisee all over India and these expertise information's were incorporated in this study.

8. HYPOTHESIS STATEMENT:

1. Franchisee based business models are not successful.
2. Majority of the Franchisors sell their franchisees with false commitments without considering ground reality.

This kind of research study is not done or published anywhere as per search on offline as well as online sources. This research is going to be an aid for the new franchisee takers to decide wisely and do not fall prey to gimmick of marketing and business promises given by the Franchisors.

9. ANALYSIS OF DATA

The Karl Pearson's correlation coefficient test was applied to the variables of the Quantitative data and the correlation between +ve and -ve variables were established.

- ❖ **Results of Correlation:** Correlation coefficient of the Break even happened as promised by franchisor and Marketing support promised by them Two variables as R value is 0.93 nearly to +1 which shows us there is strong relationship between **Independent variable:** Marketing and Advertisement Support, and **Dependent variable:** Break Even. The failure of franchise is due to the support not given by the

franchisor as promised before taking franchise. This proves Hypotheses No 1. Franchisee based business models are not as successful.

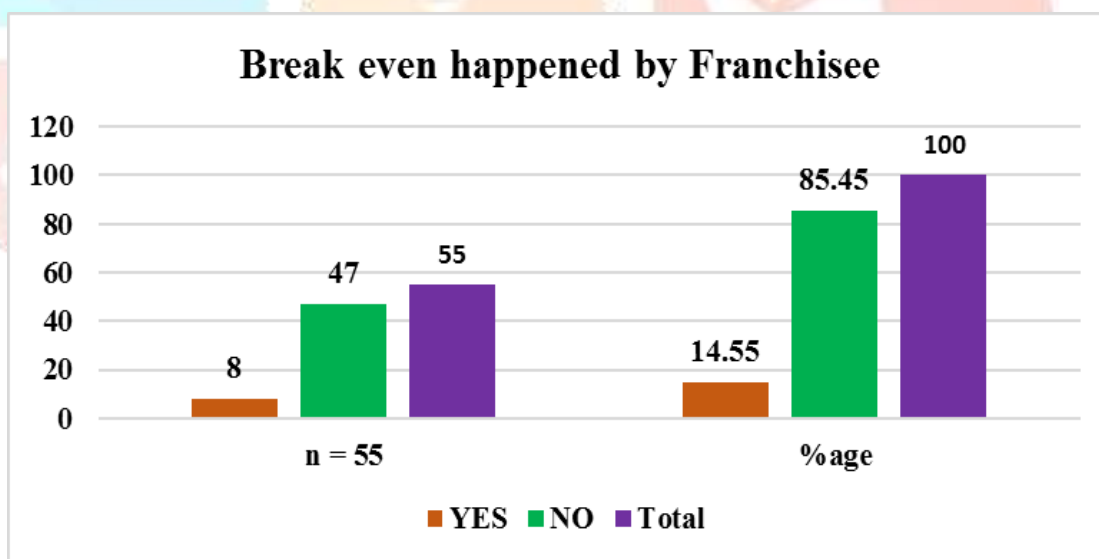
- ❖ Hypotheses 2 is an extension for hypotheses 1. We can derive that Franchisees are not successful because marketing support was not given to them. False commitment sans assurance of operational support, marketing and advertisement support was given to them at time of selling the franchisee but later it did not happen.

10. ACTUAL BREAK EVEN RESULTS

Table 1 – ACTUAL BREAK EVEN RESULTS

S.No	Description	n = 55	%age
1	YES	08	14.55
2	NO	47	85.45
TOTAL		55	100.00

Figure 1 – Actual Break Even Results



The most and decisive outcome of the survey about Break Even Point Analysis. We can see that out of 55 only 8 units i.e., 14.55% is confirmed that the Break Even happened for their Franchisee Business Proposition and 47 units i.e., 85% said the break even did not happen as per promised by the franchisor.

We are not saying they all incurred loss or the Business was shut down due to non-meeting BEP but the fact cannot be ignored that business did not do well as per expectations. Reasons could be many and more detailed investigation is required. Few may be close to BEP and few very far from the BEP but the estimate of the Franchisor to make the franchisee earn their total investment back were not met as per the schedule given to them.

11. LOCAL MARKETING AND ADVERTISEMENT SUPPORT

Local Marketing support includes local newspaper advertisement, leaflets printing and circulating local area, publishing regular classified advertisement in the major local dailies and regional magazines. FM Advertisement in city popular FM channels and buying air time for brand publicizing locally.

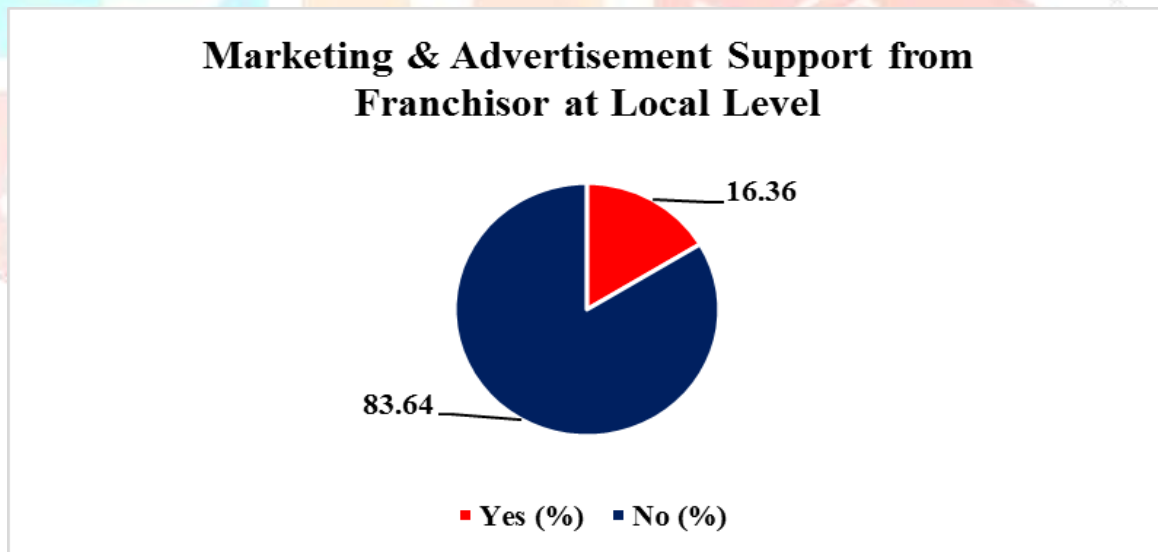
Table 2 clearly show that only 16.36% of the Franchisee has got local level support from the franchisor and 83.64% i.e., 46 units out of 55 people have been refrained from local advertisement support from the franchisor.

Franchisor is always considered and is indeed a cash rich entity with fairly large amount of cash flows dedicated for marketing, branding, business expansion purposes. But unfortunately many of the franchisee has not been given this most sought support.

Table 2 – SUPPORT FROM FRANCHISOR

S.No	Support from Franchisor	Yes	No	Total	Yes (%)	No (%)
1	Marketing & Advertisement	09	46	55	16.36	83.64

Figure 2 – Marketing Support from Franchisor to Franchisee



TOTAL FRANCHISEE COUNT TO RESPONDED FRANCHISEE FOR STUDY**Table 3 – RESPONDED FRANCHISEE COUNT**

S.No	Description	n = 55	%age
1	Non-responded Franchisees	91	62.33
2	Responded Franchisees	55	37.67
TOTAL		146	100.00

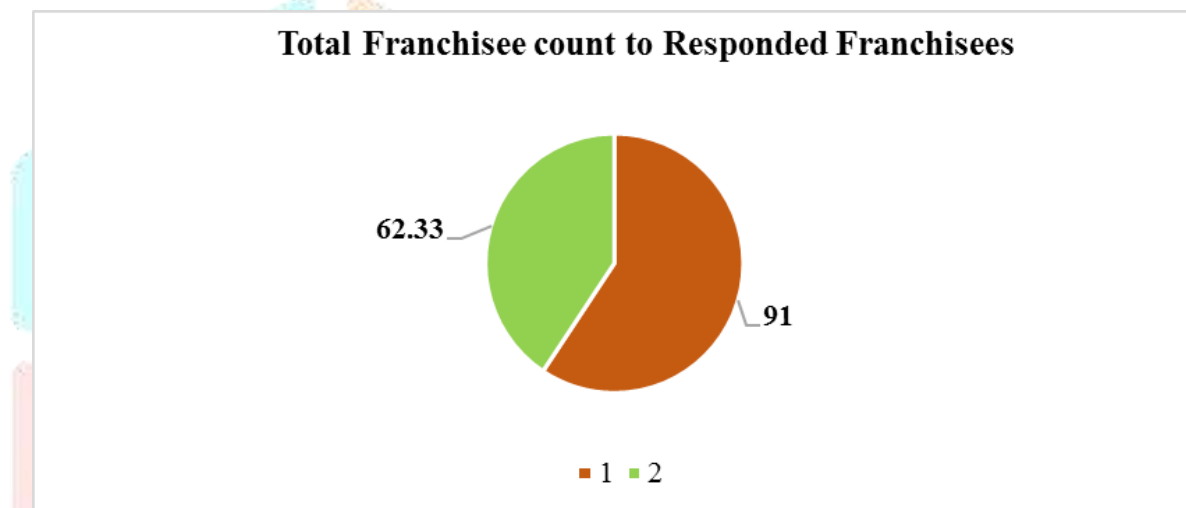
Figure 3: Total Franchisee Count to Responded Franchisees

Figure 3, explains that 37.67% of the Franchisee population responded to our questionnaire. Rest 62.33% did not responded to us. We had their details, address, phone number, email id but the data could have been changed for some of them because of which we could not reach them by telephone or email questionnaire was not responded by them. For those whose actual franchisee unit address was available we tried to reach there but the shop was found shut or the new business entity was operational at that said premises. The old Franchisee owner was either not the current business owner of the said premises.

12. CONCLUSION

The first objective of the study was, to study various franchisee models currently prevailing in the market of the sample size selected for study. 146 Franchisee data list was generated but out of 146 only 55 franchisee owners responded to us and the Questionnaire was filled for the data and analysis. It was found that there existed 15 Broad Franchised Business models under technical franchisee domain in Chennai.

The second objective was, to personally meet the actual franchisee owners and collect primary data for analysis and analyses it to generate expected outcomes. The researcher has personally met the sample size of 55 franchisees and attempt was made to personally understand their business model.

The third objective was, to check the success and failure factors for the franchisee. IT was found that out of 55 Unit Franchisees only 8 franchisees had break even happened and they were successful while balance 47 did not even attain their break even against their investment. Thus was by and largely found that major franchisees were failure and not working on profits.

The fourth objective was, to generate a Franchisee buying guide for the layman who aspires to buy a new franchisee. Researcher has made a handy franchisee buying guide which shall be an effective tool for new franchisee takers to take a wise decision and consider these success and failure parameters before getting into a franchisee agreement with franchisor.

13. LIMITATIONS OF THE STUDY

Only Technical Category Franchisees like IT Products, Car Care, Cartridge Refilling, Internet Café, Computer Training Institutes viz SRM InfoTech, CSC Training Institutes, Apollo Training Institutes were studied. There is scope for research to study the Quick Service Restaurants (QSR – Fast Foods), Casual Dining, Jewellery, Books & Gifts category Franchisee Businesses.

Due to limitations of the Time and wide spread of Geographical Area and spread of the demographic of the Religion, the researcher has limited the scope of Franchisee Selection to Chennai Metropolitan City Area only. Only franchised business models have been studied. There is scope for more study for Company Owned Company Operated Models too.

14. AREAS OF FURTHER RESEARCH

The present research study was a comparative analysis of Technical Franchises in Chennai but such research are the need of the hour for each city and state of analysis for the global picture can give a better and deeper understanding of these businesses.

A study on Company Owned Company Operated outlets based franchisee business is also the need of the hour and this is to be carried out in all other sectors like manufacturing services etc., to understand the pattern of Business operations and correlation established to find out the similarities between Regular Models and COCO.

Franchisor's must also conduct research for their unit franchisees and also competition must be analyzed to understand the improvements, scope for expansion and market acceptance parameters. Also the franchise satisfaction survey is also required.

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