

FRANCHISERS, FRANCHISEES AND SUCCESS FACTORS IN INTERNATIONAL FRANCHISING

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ABSTRACT

International franchising plays an essential role in the global business system. International franchising has been considered as one of the most successful methods of entering international markets. Despite this fact, studies focusing on international franchising appear to have been not only limited but also neglected, particularly in the Malaysian context. The review of the literature suggests international franchising has attracted much theoretical as well as empirical attention from researchers as a serious field of study.

Based on the authors' personal experiences and findings of previous studies, the present paper initiates an attempt to provide some insights into international franchising – focusing specifically on franchisers, franchisees and success factors in international franchising that have yet to be rigorously investigated - that could be both exploited and benefited by prospective franchisers, franchisees and future researchers.

INTRODUCTION

International franchising represents one of the fastest mode of expansion into foreign markets. As a method of business, franchising has been growing rapidly, particularly in developed countries. For instance, in the United States of America (USA), franchising has become the dominant method of operating retailing businesses. In the United States of America, the 1.5 million franchised outlets accounted for about one-third of the total

retail sales and is growing at about six percent per year (Shane and Spell, 1998). And according to the International Franchise Association (USA), the franchising industry has been growing steadily at the rate of at least 10 percent for the past three years. The International Franchise Association estimated that there are currently between 2,000 to 2,500 operating franchise systems and more than a half million franchise outlets throughout the USA (Rubak, 2002).

Similarly, more recently, franchising as a way of operating business is also gaining ground in developing countries. The success rates of franchise businesses in developed countries such as the USA, United Kingdom, Canada, Japan, Australia and New Zealand have attracted the franchising concept to developing countries like Malaysia. As far as Malaysia is concerned, the interest and growth of franchising can be seen not only from the increasing numbers of franchised outlets in the country, but also from the Malaysian government's involvement and commitment to the concept.

The Malaysian government's involvement and commitment in franchising can be traced back to the establishment of the Franchise Development Program by the Implementation and Coordination Unit of the Prime Minister's Department in 1992. Following this, with the formation of the Ministry of Entrepreneur Development in May 3, 1995, the Program was transferred to the Ministry as the Franchise Unit.

Even since then, franchising has been seriously promoted by the Malaysian government. This can be seen from the increased support programs from the government in the forms of financing, information, training and quite recently, the Franchise Act 1998 which was introduced to regulate the franchising industry in Malaysia. These developments represent the evidence that suggests the franchising industry is going to be an important component of the Malaysian business system.

Since its introduction, franchising has experienced growth and acceptance as a good method of doing business. Surprisingly, despite its growing acceptance and importance in the Malaysian economy, the

review of the literature reveals that franchising has not attracted much research attention. In Malaysia, although the numbers of franchised businesses are increasing, little is actually known about the industry. Information on franchising, specifically on international franchising in Malaysia is still very limited. Even today, no one can really claim to know the actual numbers of franchised outlets, the most common types of franchising, their success rates and contributions to the national economy.

In view of the importance of franchising and the lack of information concerning factors that can determine franchising development in Malaysia, more research are needed in this area of business. A particular area of research interest would be to examine the steps used to select franchisers, franchisees as well as the factors contributing to the success of international franchise systems. This is so because the steps for selection and success factors can not only affect an international franchise system, but also its future growth and survival. Moreover, information concerning the right steps for selecting and factors contributing to franchise success is still limited in Malaysia.

The information concerning these aspects of franchising could be exploited by the government, franchisers, potential franchisees and even future researchers. By understanding the important steps in selecting and success factors, individuals intending to participate as franchisees would know what to expect from a franchiser and vice versa. At the same time, with better understanding of franchising, the government could formulate and implement more effective strategies in providing the needed assistance to promote the healthy growth of the franchising industry in Malaysia.

Based on the authors' previous working experiences (McDonald's Corporation, Domino Pizza, Pro Image and Friendly Restaurant in the USA and Kentucky Fried Chicken in Malaysia) and the findings of past studies, this paper attempts to provide some insight into the important steps for selecting franchisers and franchisees as well as examining the success factors of international franchising. Towards this end, this paper is divided into the following sections.

Section Two begins by examining the concept of international franchising. The types of franchising is presented in Section Three. Next, Section Four explains the structure of a typical international franchise system. Following this, we describe the advantages and disadvantages of international franchising in Section Five. Section Six of the present paper examines the important steps in selecting franchisers and franchisees. Based on previous studies, Section Seven highlights some of the factors that contribute to franchise success rates as documented in the literature. Lastly, Section Eight presents the concluding remarks for the paper.

THE CONCEPT OF INTERNATIONAL FRANCHISING

Though its definitions and descriptions vary, in general international franchising may be defined as a business opportunity by which the foreign owner of a service or a trademarked product grants exclusive rights to a local individual or company for the domestic distribution and/or sale of the service or product (normally within limited exclusive territory), and in return receives a payment (normally initial franchise fee) and royalty and conformance to agreed standards. The individual or business granting the business rights is known as the franchiser and the person or company granted the right to operate in accordance with the prescribed method to produce or sell the product or service is called the franchisee (adapted from Justis and Judd, 1989).

Under such business agreement, the franchisee is allowed only to distribute or sell the service or product (standardized) solely decided by the franchiser. At the same time, to ensure that the franchisee will succeed under such business arrangement, the franchiser will require the franchisee to fully adopt the franchiser's brand or trademark, proven methods of operation (standardized processes and operating procedures), marketing efforts, management, technical expertise and advice, training program, and other supporting services.

Types of Franchising Systems

There are different types of franchising systems. The types of franchising are determined based on the relationships between the franchiser and the franchisee. In general, however, franchising can be grouped into four distinct types. According to Vaughn (1979), the four types of franchising systems are:

- 1) the manufacturer-retailer system;
- 2) the manufacturer-wholesaler system;
- 3) the wholesaler-retailer system; and
- 4) the trademark/trade name licensor-retailers (or popularly known as the business format franchising).

As far as the types of franchising are concerned, the first three normally cover the supply of products and trade names. However, unlike the first three types, the business format franchising goes beyond that and cover other important aspects of how the business should be operated and managed. In other words, in business format franchising, important areas such as training, merchandising and management are also included and emphasized.

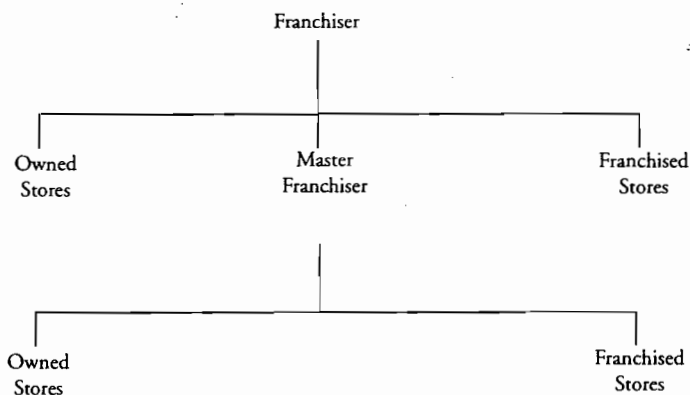
Of the four types of franchising, business format franchising appears to have been experiencing tremendous growth in franchising since the 1950s (Justis and Judd, 1989). As a matter of fact, in Malaysia, this type of franchising has had rapid expansion in businesses such as restaurant, hotel, printing, services and retailing.

Structure of an International Franchise System

Most international franchise systems consist of the franchiser, the master franchisee and the franchisee. As the owner of the franchise system, the franchiser generally operates its own franchise stores and at the same time, may sell its proven business format to the master franchisees as well as individual franchisees.

As a master (regional) franchisee of an international franchise system, the individual or company holds the business rights to operate within specific geographical market (a country or within countries). The master franchisee takes the business rights to the geographical market and is required to sell franchises within that market. Normally, the master franchisee has to agree to operate a specific number of stores and is also responsible for selling franchises, providing training and the supporting services to the franchisees in the geographical area. Many owners of franchising systems adopt this method to expand internationally. The following Figure 6.1 displays the typical structure of an international franchise system.

Figure 6.1: Structure of an International Franchise System



Advantages and Disadvantages of International Franchising

Generally speaking, all forms of businesses have their share of problems and unique benefits. As far as international franchising is concerned, past studies have from time to time established their advantages and disadvantages. Some of these disadvantages and advantages are presented in Tables 6.1 and 6.2 below.

Table 6.1: Disadvantages of Franchising

Disadvantages:	
1.	Limited scope for individual initiative for product, service or design.
2.	Royalties, franchise fees and advertising expenses.
3.	Not at the liberty to sell franchise without permission from franchiser.
4.	Territory agreements may be difficult to enforce.
5.	All sorts of controls and obligations on franchisee to maintain standard and quality.
6.	The failure of franchiser may leave the franchisee isolated.

Table 6.2: Advantages of Franchising

Advantages:	
1.	A proven business format or product and service.
2.	A recognized name of which the public is already aware.
3.	Publicity through the franchiser's outlets.
4.	Reduced percentage of expensive errors by adoption of a tested format.
5.	Direct and close assistance and supervision during the set-up of new store.
6.	Training on production and management aspects provided for.
7.	Operating and training manual provided.
8.	Better terms for centralized bulk purchase.
9.	Research and development in improving product and service.
10.	Able to compare notes with other franchisees.
11.	Design of premises provided for.
12.	Advice on equipment selection and inventory level.
13.	Assistance in site selection.
14.	Protected and privilege rights within a given territory.
15.	Improved prospects of obtaining financing from banks.
16.	Backing of a known trading name.
17.	Greater chance of success.
18.	Standardized quality of goods/services.
19.	International advertising programs.

Selecting Franchiser and Franchisee

Probably one of the main reason why international franchising has been so successful is the mutual benefits that it is able to offer to both the franchisers and franchisees (Scarborough and Zimmerer, 1998). As a matter of fact, according to Green (1994), the close working relationship between the two parties is also the most critical aspect of franchising.

As far as the shared benefits are concerned, franchising provides the franchiser a relatively fast way of expanding its business system with minimum capital and at the same time, without cost and inconvenience of location in international markets. Correspondingly, the franchising system offers the franchisee the opportunity to own a business with a proven track record (established product, brand name and business format). And since the success of a franchising system depends on the relationship between the franchiser and the franchisee, knowing the criteria for selection is very important for both parties.

In general, the franchiser wants the best franchisee, and the franchisee wants the best or reputable franchiser. A franchiser with a poor franchise system to offer is unlikely to be able to attract the best franchisees. Likewise, franchisee without the necessary requirements will not be offered the franchise ownership. In line with this, the selection steps described below can help to avoid uninformed, blind gamble on new franchiser as well as franchisee.

Choosing a Franchiser

For a prospective franchisee, a major question concerns identifying a reputable franchiser. To own a reputable franchise, the prospective franchisee must know where to secure established franchisers. There are numerous sources of information and opportunities on international franchises. Some of the major franchise options are listed in the following Table 6.3.

Table 6.3: Sources of Information on International Franchises

Sources:	
1.	Advertisements in newspaper, trade journals (magazines) and business magazines.
2.	Trade/franchise exhibition.
3.	Roadshows by franchisers
4.	Franchise Opportunities Handbook (published by International Franchise Association).
5.	The Franchise Development Program (Ministry of Entrepreneur Development).
6.	Malaysian Franchise Association.

To avoid unscrupulous franchisers, the prospective franchisee should investigate thoroughly the companies, evaluate the franchisers, their reputation and business records. One of the best way to avoid dishonest franchisers is to examine carefully the information in the Uniform Franchise Offering Circular (UFOC).

The UFOC or franchise prospectus is a disclosure document which contain various information concerning a franchise as required by the law (as in the United States of America). In the USA, the Franchise Investment Law requires franchisers to give a copy of the UFOC to prospective franchisee before any offer or sale of a franchise. Table 6.4 below summarises the information contain in a UFOC.

Table 6.4: Content of UFOC

Item:
1. Background of franchiser
2. Business experience of franchiser
3. Litigation
4. Bankruptcy
5. Initial franchise fee
6. Other fees
7. Estimated initial investment
8. Restrictions on sources of products and services
9. Franchisee's obligation
10. Financing
11. Franchiser's obligation
12. Territory
13. Trademarks
14. Patents, copyrights and proprietary information
15. Obligation to participate in the actual operation of the franchise business
16. Restrictions on what the franchisee may sell
17. Renewal, termination, transfer and dispute resolution
18. Public figures
19. Earnings claims
20. List of outlets
21. Financial statements
22. Contracts
23. Acknowledgement of receipt

In reviewing the UFOC, it is advisable for a prospective franchisee to get lawyers experienced in franchising, accountants and other professionals. Although the information in the UFOC does not protect or guarantee the success of a franchisee, it does, however, provide valuable information for investigating the franchiser, the franchise system and its status in the industry as offered.

Apart from examining the UFOC carefully, it is also extremely important for prospective franchisee to read and understand the terms of the franchise contract or agreement. The franchise contract contains the details (terms) that will govern the relationships between the franchiser and the franchisee. With regard to this, it is best for a prospective franchisee to get help from experienced lawyers to scrutinize the franchise contract before agreeing to accept the franchise. The summary of the content of a franchise agreement is presented in Table 6.5 below.

Table 6.5: Master Franchise Agreement

Section:
1. Definitions
2. Grant
3. Fees, royalties, and advertising expenditures
4. Proprietary marks
5. Operating manual
6. Copyright protection
7. Training and assistance
8. Development of region
9. Operation of stores
10. Advertising
11. Information technology
12. Reports, accounting records and right of inspection
13. Insurance
14. Covenant not to compete
15. Currency and payment
16. Taxes
17. Term, termination and renewal
18. Assignment, transfer and encumbrances
19. Right of first refusal
20. Confidentiality
21. Indemnity
22. Compliance with the laws
23. Governmental approvals
24. Miscellaneous

Management Training and Ongoing Support Services

In addition to the above steps, prospective franchisee must also ensure that the franchiser would also be able to provide adequate management training and ongoing support services (prior to opening a new outlet as well as during the operation of the outlet). These services are vital since most franchisees may not have sufficient experience in running the business. Reputable and successful franchisers normally supplement their startup training programs with ongoing instruction and support services (such as advertising, promotion, merchandising, customer service, quality control and general management) to ensure that their franchisees would not fail.

Taking other steps such as talking to current and former franchisees, doing some market research, and preparing a checklist of questions for the franchisers can also help a prospective franchisee evaluate the reputation of the franchiser. A prospective franchisee in Malaysia can also obtain valuable information on franchisers from the International Franchise Association, Malaysian Franchise Association and the Franchise Unit in the Ministry of Entrepreneur Development.

Selecting Franchisee

In selecting franchisees, generally franchisers look for franchisees who are willing to follow the franchiser's business system, has sufficient financing to make the business work, as well as understands the importance of quality and superior customer service. However, to ensure higher success rates among their franchisees, reputable and experienced franchisers will look for certain important characteristics. Normally, the well-established franchisers will screen out applicants who do not have the characteristics. Table 6.6 below displays some of the characteristics that well-established franchisers look for.

Table 6.6: Characteristics of Franchisees

Criteria:	
1.	Financially stable.
2.	Some previous experience.
3.	Some education.
4.	Risk taker.
5.	Desire to succeed.
6.	Leadership qualities
7.	Management skills.
8.	Willing to work hard
9.	Willing to learn.
10.	With good references.
11.	Not so independent

Factors Contributing to Franchise Success Rates

One of the important reason why franchise businesses have been experiencing tremendous growth and acceptance is their business success rates. The review of past studies suggested that business success rate is much higher among franchise businesses as compared to other forms of small businesses. As reported by the United States Department of Commerce (1996), only 23 percent of small businesses survived to their fifth year. On the contrary, the success rate is as high as 92 percent for franchise businesses.

Franchise businesses have recorded less than a five percent annual failure rate (Green, 1994). Similarly, other studies have also substantiated the lower rate of failure among franchise businesses. According to Green, the study conducted by Arthur Andersen & Co. in 1991 found that 86 percent of franchise businesses survived in their fifth year of operations. Likewise, the study conducted by FranData Corporation (1992) revealed that only 4.2 percent of franchisees leave a franchise system on an annual basis (reported in Green, 1994).

As far as business success is concerned, a franchiser cannot and does not guarantee the success of the franchisee. However, the success of the franchise businesses depend on various internal and external factors.

Among the most critical factor is the close working relationship between the franchiser and the franchisee. The success or failure of a franchise system depends largely on this essential relationships.

According to Vaughn (1979), initiating and maintaining wholesome relations between franchiser and franchisee are instituted for various reasons. Among these are: 1) to motivate franchisees to perform at high levels in terms of internal operations and marketing; 2) to facilitate the adoption of new ideas; 3) to obtain new ideas from franchisees; and 4) to head off legal problems in the antitrust and trademark and trade name fields.

In addition to the above franchiser-franchisee wholesome relations, success in a franchise operation also requires other key factors such as the franchisee best efforts, capabilities (in terms of knowledge, skills and attitudes), effective management, and efficient operation of the store. Furthermore, success also depends on external factors such as general economic trends and other local marketing conditions.

CONCLUSION

This paper attempts to provide some insight into international franchising. Based on our experience and the literature reviews, we highlighted the essential steps in selecting franchisers, franchisees as well as examined some of the important factors contributing to the success of franchise businesses. In particular, we suggest that potential franchisees should carefully investigate new franchisers before making investment decision. With regards to this, it is important that franchisees read and fully understand franchise documents (specifically the UFOC and franchise contract) and seek professional advice regarding any concerns and questions.

Though we approached this paper from a prescriptive approach, our practical experience in franchising suggests rich avenues for future research. Moreover, since important information concerning franchising

is still lacking in Malaysia, we foresee various research opportunities in the area of franchising. Issues such as strategic choice and adaptation (Dant et al, 1996), franchisee job satisfaction (Morrison, 1996), motivations of franchisees (Peterson and Dant, 1990) and efficiency in franchising (Bronson and Morgan, 1998) would be worth investigating and useful to both franchisers and franchisees in Malaysia.

In conclusion, it is hoped that this paper will not only increase our understanding of international franchising, but also generate more interest in this field from an empirical perspective, specifically in the Malaysian context.

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