

ENTREPRENEURSHIP AND DESIGN THINKING

LECTURE 4: FRANCHISING AND ENTREPRENEURSHIP

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Introduction

- In our last lecture we did mention, though without much explanation franchising a form of business ownership that entrepreneurs can organize their business around.
- In this current lecture we will look at it in detail; What it is, its advantages/applications and disadvantages as well as management issues that comes with it.

Learning Outcomes

1. Describe the concept of franchising
2. Describe different types of franchising open to an entrepreneur
3. Pinpoint factors behind successful as well as failed franchises
4. Argue why franchise may or may not work for an entrepreneur

Overview

- Franchising is a special form of licensing or a business model whereby, a company/owner (franchisor) grant another company or individual(s) called franchisee the right to operate a business using the franchisor's proven business practices, brand name, products or services.
- The franchisee in return pays an initial amount and a regular say yearly royalties to the franchisor.
- This form of business is common in sectors such as fast food, retail, gym and fitness, hospitality, and gas stations among others.

The key Components of Franchising

- **Franchisor-** Is the owner of a product, service, trademark, business name, and/or practices that have been proven to work, who licenses them to franchisee. The owner pledge support to the franchisee.

- **Franchisee-** This is the entrepreneur who, after spotting an opportunity in their market, purchases the right to operate the business under the franchisor's brand. He pays an initial amount and regular amount thereafter.
- **Franchisee Fees and Royalties-** This is the amount that the franchisee pays to the franchisor for using their brand name and the continuous support in running their business. The royalties could be between 4% to 12% but vary depending on the industry, age, and location of the franchise.
- **Franchise Agreement-** This is a legal contract between the franchisee and the franchisor capturing the responsibilities, obligations, and rights for each in the engagement.

Reflection:

From your locality can you identify some franchises?

Types of Franchises

As an entrepreneur, it is important to understand the different forms of franchise as each has a unique structure and approach. This will go along with helping you to know which form to apply, where and when. There are five such forms though two may be the common ones. In the next section we will look at each form;



Source: https://stockcake.com/i/exploding-soda-can_1262341_173791

1. Product Distribution Franchising

- This is a business where the franchisor leaves the business operation to the franchisee.
- The franchisor provides the franchisee with the products, branding, and sometimes equipment.
- The franchisee has the sole right to distribute franchisor's products in a market or geographical scope.
- It is considered the easiest form of franchising since the franchisee doesn't need a lot of capital.
- This is common in beverage, automotive and gasoline industries.
- Success stories for this form would be Coca-Cola, which allow different businesses in different countries to produce and distribute their products.
- An example of a failed franchise in this category would be Blockbuster store, a video rental business that failed to adapt to the digital revolution (Source, 2016).

2. Business Format Franchising

- In this model the franchisee gets the rights to use the franchisor's trademark (distinctive mark that identifies a product from the rest), and business model such as marketing, training and regular operational support.
- This could be in addition to selling the franchisor's products. The model is common in fast food, retail, education, and fitness sectors.
- A successful case would be McDonald whose growth has been tremendous across many countries.

3. Management Franchising

- In this form, the focus is on the running of the business rather than the direct sales.
- The franchisee is responsible for leading the team and day to day operation of the business while the franchisor provides strategic direction and business model.
- This model is so common in the hotel industry. Successful case in point, including **Hilton Hotels and Resort**, have grown in their global reach.

4. Investing Franchising

- This form involves large-scale investment whereby the franchisee injects large amounts of capital but does not (necessarily) engage in the day-to-day running of the business.

- The franchisee may hire a team of management to run the business on their behalf, therefore being a source of passive income stream to them.
- **Marriott International** operates most of their hotels through investment franchising.

5. Conversion Franchising

- In this form, an existing business is converted into a franchise unit.
- The independent business becomes a franchise and adopts the franchisor's brand name and business model.
- It is a quick way to expand for the franchisor through leveraging existing businesses. It is common form in service industries, automotive repairs and real estate.
- A good example of a successful case under this category would be **Century 21 Real estate** firm which allows existing real estate firms to become a franchise.

Factors Contributing to Successful Franchise

1. Strong Brand Reputation

- A brand name that is well known and recognized attracts the customer's trust and royalty; it also attracts franchisees.
- This tends to give such brands a competitive advantage in their respective markets.
- Think about brands such as Starbucks, KFC, and McDonalds, they all have established themselves over the years (Franchisefinesse, 2023a).

2. Support and Training

- For a franchise to be successful there is a need for constant support and training of franchisees in order for them to maintain the required standards for the franchisor business.
- Where this is not available chances are the franchise might fail miserably.
- Remember the franchisee pays for these services.
- **Subway** is a case in point of franchisees that offer extensive training and support to its franchisees.

3. Proven Business Model

- A key to success of any franchise is having a well-established and tested model.
- This means that there have been enough iterations of the franchise' business model thereby reducing the risk of failure.

- If anything, it is based on this that franchisee is willing to pay for the model and the brand.
- Companies such as Starbucks with its coffee experience model and KFC with its secret recipe are examples of proven models in franchise.

4. Localization

- This talks about the extent to which the franchise allows and is able to make changes to accommodate different market needs.
- A good example would be KFC in China and Africa where they have adjusted their menu to incorporate the local preferences.

5. Innovation and Technology

- Any business must keep up with changes in technology among other fronts.
- A franchise that is always innovating is likely to be ahead of its competitors.
- Those that are quick to take advantage of technology might gain mileage in their industry.
- This has been the case with most food outlets where they have now their app where customers can order online.

Arguments for and Against Franchising

Advantages

- i. **An already established brand:** The entrepreneur/franchisee is not starting from scratch but rather is riding on an existing brand which makes it easy to enter the market.
- ii. **Reduced risk:** Given we said franchise come with a tested business model; it scales down the risks that may be associated with a new venture for the entrepreneur.
- iii. **Constant support and training:** The burden of training and support lies on the franchisor, therefore the franchisee benefits from regular and up to date training that helps the business to grow.

- iv. **Marketing and Advertising:** The franchisee benefits from the global or regional marketing campaigns and advertisements that may be done from time to time by the franchisor. This will definitely have an impact on sales and traffic to their business.
- v. **Bargaining power:** The franchise is likely to have bargaining power when purchasing suppliers as it is a brand to reckon with and given the possibility of bulk buying.

Disadvantages

- i. **Costly:** The initial cost and regular fee may require significant financial commitment from the side of the entrepreneur.
- ii. **Inflexibility:** Given that the franchisor through the franchise agreement has spelt out terms and conditions, the franchisee must at all times adhere to such without deviation. This may be limiting to the entrepreneur who would wish to innovate and be creative.
- iii. **Contract:** The contract between the franchisor and franchisee if long-term could lock in an entrepreneur who may wish to exit the business.
- iv. **Profit/Revenue sharing:** Royalties that the franchisee is required to pay the franchisor are at times discouraging.
- v. **Reputation Risk:** Whenever the brand is mentioned or involved in negative publicity even outside entrepreneur's market the impact will be felt and could affect sales and profit of the business as customers are likely to associate the brand whenever they are.

Emerging Trends in Franchising

- **Micro-franchising-** There is a move towards smaller-scale franchises, which require lower capital investment. These are common in emerging markets and developing nations. Such businesses are in the water and milk vending business.
- **Eco-friendly and Sustainability concerns-** Now than ever before consumers are demanding businesses that are taking care of their environment and proactive to issues such as climate change.
- **Evolving consumer preferences:** Consumer preferences are always on the move across all the sectors, and this is calling for franchises to be in tune with the changes. In fast food industry concern for healthy food is a growing concern that must be addressed.
- **Technology Integration-** We are seeing more and more franchise leverage on advances in technology such as robotics, artificial intelligence, data mining to streamline their operations, improve customer experience and drive their business.

Topic Review

Franchising provides an easy and quick way for an entrepreneur to enter or start a business building from an existing, well reputable, tested brand name. It is important to note that this is not without some challenges such as the inflexibility of the business model. In this topic we have looked at definitions of franchising, advantages and disadvantages as well as some emerging trends with the business. In the next lecture we will focus on a very related topic called “**Buying an existing business**”.

References:

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