
FRANCHISING: BUSINESS FORMULA OF 21ST CENTURY

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ABSTRACT

The main purpose of the present research report is to present and analyze franchising as an alternative growth strategy for tourism enterprises that combines a variety of products, services and corporate strategies. Special emphasis is laid on the essential characteristics of franchising as a specific business model for company growth and development. With a view to its specific features, franchising is considered to be one of the most successful business formats in 21st century. The focus is put on the role of the so-called 'responsible franchising', which is providing added value to franchisees by teaching them how to achieve a competitive advantage and maintain a wide range of customers willing to consume franchise products and services. The advantages of franchising are analyzed in details as a method of growth and expansion in the tourism industry. Disadvantages and limitations of this financial instrument are considered, too. The profile of the Bulgarian franchise model is studied as well as the present status and trends of franchise development in Bulgaria. Current problems of the franchise market in this country are discussed.

Keywords: Franchising, Growth Strategy, Tourism Enterprises, Responsible Franchising.

FUNDAMENTAL CHARACTERISTICS OF FRANCHISING

In recent decades franchising has emerged as popular expanding business tool, which combines diversity of products, services and company strategies. This business model became an **effective opportunity** for small tourism enterprises, which cannot afford to finance their development (Dant & Kaufmann, 2003).

A lot of trade formulas and business strategies are defined with the term 'franchising', but often this denotation is given to them incorrectly (Bermúdez, 2002). Defining the franchising concept is a task related to many difficulties, because depending on the perspective of study (law, trade, institutional, etc.), more attention is paid to some aspects than to others. Franchising is a **commercial relationship** between two agents – franchisor and franchisee, who are legally and financially independent, but share a common goal (Insa-Ciriza, 2003). Franchising is based on a contract, by which the franchisor gives to the franchisee the right to use a **developed business concept**, including brand name, products, marketing services, methods and manners of managing the business, in a specific field against payment. Usually in the franchising system there are several franchisees, which have similar cooperation agreements with one and the same franchisor. This allows them to work together on the market by a cooperative system. In this context Díez et al (2005) define franchising as a **cooperative system** between different organizations, bounded by a contract, by which one of them, called the franchisor, gives against payment to the other party, called the franchisee, the right to use the brand name and/or the commercial formula, materialized by certain distinctive signs. The franchisor guarantees at the same time technical support and the necessary regular maintenance services during the term of the contract. From this definition the following **fundamental characteristics of franchising** can be found:

- Franchising is a cooperative system.
- Relations between the two parties are established by a contract.

- Participants in this system are the main company (franchisor) and the companies which sign the contract with the franchisor (franchisees).
- The franchisor provides to its franchisees brand name, commercial formula or know – how, technical or other support during the term of the contract.

Another definition of this **intellectual and financial tool** is given by Bermúdez (2002). He perceives franchising as a **business system for cooperation** which aims to connect two economically and legally independent units in long-term plan with a contract by which one of them (franchisor) provides in good faith to the other (franchisee) the rights to use its business, production, distribution and marketing of tangible or intangible products with proven quality. This product may include basic and extra services, which might be secured (patents, brands, and etc.) or unsecured (know – how), however all of them should be sufficiently tested, effective and licenced. In return of received rights each franchisee is required to make periodical or lump-sum payments to the franchisor. According to this definition **six interchangeable flows** take place between the parties under this contractual relationship:

- ✓ *Information flow.* Information has to pass between the franchisor and the franchisee,

as well as between the franchisees themselves. This helps for solving emerging problems, exchanging information about the market and various competencies, and for receiving of services and training required by the franchisee.

- ✓ *Material flow.* The right to operate the business of one or more brands with regard to

products, services and know – how, listed in the contract is a prerequisite condition for both parties in a franchise relationship.

- ✓ *Physical flow.* If between the franchisor and the franchisee exists a relationship that aims to exchange material goods, then the physical flow is carried out by the members of the distribution channel.

✓ *Financial flow.* The franchisee has to pay off for the goods, services and ideas that it has received by the franchisor.

✓ *Satisfaction information.* It is necessary to have information about the extent to which the expectations of the contractual parties – the franchisor and the franchisee, are satisfied with a view to making subsequent decisions.

✓ *Transparency.* Giving true and complete information is an important requirement for maintaining a long-term relationship between the parties.

Franchising might be seen as an **alternative growth strategy**, because the owners of franchise companies are not directly responsible for the financial investments, necessary for the expansion of their businesses. This financial responsibility is taken by franchisees that pay to the franchisor the right to use its trademark and business package against payment of an initial fee and royalty. In the future that capital becomes a valuable and a profitable asset for future business expansion.

In terms of business, the franchise system is an **alternative way to create companies with less risk**, which is a consequence of the application of a proven management model. Therefore, franchising contributes to the expansion of business structures that have already been established. It is important to note that not every company or business could operate by using franchise model. For this purpose, franchising needs a key element for success that is already proven by the franchisor, which has to be distinguishable and able to pass to future franchisees by some adequate training. If this process is not realized in the best way, the company will fail in short or medium period of time.

As a **marketing instrument** and a **distribution tool** of products and services, franchising is suitable for certain tourism enterprises. Before any tourism enterprise considers franchising as a **method of rapid expansion**, it is necessary to take into consideration a number of legal and business practices. Many tourism companies prematurely choose franchising as a **growth alternative** or a **strategy for international rollouts**. Other organizations resort to it, driven by unqualified consultants, who are interested in the professional fees received, rather than in the long-term success of the proposed franchise program (Chen, 2010). This causes financial distress and business failures of both, the franchisor and the franchisee and often evolves into litigations. Therefore companies that are part of

a franchise system should be responsible for the establishment and development of their franchise programs. Such attitude towards this financial tools is known as **'responsible' franchising**.

FRANCHISING ELEMENTS THAT PROVIDE COMPANY GROWTH

'Responsible franchising' is the only way in which growing tourism enterprises and the franchisees could exist in a harmonious environment in 21st century. It requires a secure foundation on which the franchise program to be developed. The core of the responsible franchise model is based on the understanding of the strategic nature of the business structure. Franchise system consists of **three basic elements** – brand name, operating system and ongoing support from the franchisor to the franchisee (Barnes, 2001).

The brand name creates demand that initially helps the franchisee to attract customers. It includes trademarks and service marks of the franchisor, commercial interior, and all the intangible factors that create customer's fidelity and build market value of the service (Parusheva, 2013). The **operating system** provides the promise that allows franchisee to maintain good relations with its customers and build loyal relations with them. The **constant support** and training boost growth and provide to the franchisee tools and tips for expanding the customers base and for developing an independant market share.

The responsibly established franchising system is such a system that provides added value to its franchisees, by training them how to achieve competitive advantage and maintain a wide range of customers, who are willing to consume their products and services. Many of the disputes in franchising relations are based on the difference between the actual needs of the franchisees to retain their market niche and the current support from the franchisor. Major discussions are generated by the wish of the franchisee to acquire competitiveness and the failure of the franchisor to comply with the contractual promises, the initial support and the continuing training (Abrams, 2010).

Every organization which treats franchising as a **method of growth and expansion** should understand its **basic components** that could be synthesized in the following areas:

- ✓ **Proven business concept:** provides a basis for applying the franchise program.
- ✓ **A strong management team** consisting of internal experts and qualified consultants: they must be familiar with both the specific characteristics of tourism industry and the legal and business aspects of franchising as a method of expansion.
- ✓ **Sufficient financial capital:** it is required for starting and maintaining the franchise program; it should be available for the developing tourism company for providing initial support and subsequent assistance to the franchisees.
- ✓ **Availability of distinguishable and protected commercial identity:** it includes registered trademarks, uniformed appearance, and distribution policy that create the overall image of the franchise program.
- ✓ **Patented and proven methods of operation and management:** these shall be presented in a detailed operation manual that helps the franchisees to implement their operational work.
- ✓ **Ability to protect the intellectual products:** it is a key point, in case of duplication of the product range by competitors and it is manifested by clear and objective standards established for quality control.
- ✓ **Comprehensive training program provided to the franchisees:** this shall integrate all the latest education and training technologies.
- ✓ **Ability to use a support staff** by qualified teachers: they shall support the franchisees during the work process periodically, and shall monitor the quality control.
- ✓ **A set of complex legal documents:** they reflect the business strategy and the operating policy of the company. There should assure a delicate balance between the rights and obligations of the parent tourism enterprise and the franchisee, respectively.
- ✓ **Providing continuous market demand for products and services** by the growing tourism enterprise subject to distribution through franchising. The products and services offered in the franchise package must comply with certain minimum quality standards. They should not be a subject to rapid changes to the consumer's preferences. The study and analysis of the market is necessary to comply with the current trends in the economy and with the competitiveness of the tourism industry.

- ✓ **Carefully designed set of uniform criteria for selection** of the site and architectural standards.
- ✓ **Understanding of the competition**, assessment of direct and indirect competitors, and reliable marketing and sale policy, developed by the franchisor for the franchisee's needs.
- ✓ **Agreed relations with suppliers**, creditors, foreign companies, as well as with the key resources related to them.
- ✓ **Secured and tested control system targeted** to define the minimal financial possibilities as well as careful study of the latest trends in hospitality industry, needed for the company's success.
- ✓ **Preparing and analyzing the market profile** of the franchisees.
- ✓ **Effective system for reporting and supporting** the payment of the royalties on behalf of the franchisees.
- ✓ **Exploring possibilities of introducing new products and services** for the consumers through franchise network.
- ✓ **Developing a solid communication system** that facilitates dialogue with the franchisees, and reduces the chances for conflicts and disputes with the franchise network.
- ✓ **Providing stable national, regional and local advertising, marketing and public relations programs** for recruitment of potential franchisees as well as users of websites moderated by franchisees (Spencer, 2010).

ADVANTAGES AND DISADVANTAGES OF FRANCHISING FOR TOURISM INDUSTRY

There are various **reasons** for which the developing enterprises within the tourism industry prefer to use franchising, as a **method of growth and expansion**. Having this tool they manage to:

- achieve efficiency in the working process and economies of scale;
- penetrate quickly on the market at low capital costs;
- effectively redirect costumers by advertisements and promotions;
- achieve sale of products and services using special distribution network;
- satisfy internal company needs and motivate the work force;
- provide training and management of the personnel, local advertising and other administrative activities in favour of the franchisees.

The major **advantages** that franchising provides to the entrepreneurs, and which could serve as a background for using its potential, are summarized in the **following areas**:

- ✓ an option for obtaining a substantial profit, without the need to invest in high-risk operations;
- ✓ opportunities for quick expansion by using foreign resources;
- ✓ use of the advantages of the franchisees' potential and contacts on the local market;
- ✓ saving costs and time in recruiting, hiring and motivating personnel of the separate sites;
- ✓ achievement of economies of scale.

Franchising is **the fastest growing business expansion strategy** that has ever been created. In few years, by applying franchising many companies enlarged, and from several enterprises, or even from a single one, they turned into large chains with many offices. No other approach for business expansion has come closer to the opportunities and scopes that franchising offers. The major part of this success is due to the mutual benefits for both parties (franchisor and franchisee) under the contract (Tadarakov, 2013).

Along with obvious advantages of this partnership concept, the eventual **disadvantages** cannot be neglected, which concern both parties under the franchise agreement. The major disadvantage for the franchisee is the loss of control over the management of their company. Along with the benefits such as the right to use the trade mark, consulting, training, recognition of the offered goods or services, the franchisee is bound to follow the rules, imposed by operation manuals, and as well as to consult about every change that they think might have beneficial effect over the dealings with the franchisor.

Another core problem is that usually an unfair behaviour of either party under the franchise contract, could easily lead to legal proceedings for forfeits. Such franchisee could lead to the loss of confidence in the brand, which is spread over vast territories and to gain again the lost image and good will much efforts and money shall be needed. The opposite assumption is not uncommon, too – when franchisors, due to their incompetence and failure to pay sufficient efforts to the

promotion of the trade mark, at the end they lose their franchisees. This assumption should also be taken into consideration and the franchisee have to be very careful when choosing franchise and studies the contractual terms and conditions.

When launching a franchise, although the parameters are set by the franchisor, it should be taken into account that costs might be higher than those that are initially planned. One of the setbacks of the starting-up franchise is the clause for purchasing the equipment and materials (including raw materials) from the franchisor, which are sold as a rule at higher prices than those at free market. Significant expenditure is also the declared by many franchisors advertising charge, which could be a fixed cost and not an element of the turnover.

Another important drawback is that the strength of the chain is defined by its weakest link. Even if a franchisee puts the utmost efforts to follow strictly the franchise model, there is no guarantee that another franchisee should not discredit the confidence in the trade mark causing the first one to suffer direct losses. Here comes the role of the franchisors themselves to take control over the quality of service with a view to avoid occurrence of such problems in their chains that might have impact over the other outlets of the chain.

PROFILE OF BULGARIAN FRANCHISE MODEL

Franchising is the most successful **business model** in the contemporary world. It allows anyone to start its own business immediately, using the brand and business model of proven franchise chain. That **market growing strategy** possesses a real potential to turn a small business into a large one.

Although **the popularity of franchise** is growing in **Bulgaria**, a small part of the active business entrepreneurs are aware of its specific features and practical focus. **The major reasons** for the fast franchise grow are the offering of a strong and known brand, as well as the established business model, providing know-how and good practices. A few groups of Bulgarian investors are willing to buy franchise rights. They could be specified, as follows:

➤ **Experienced entrepreneurs in business management**, owning a certain amount of capital for investment and willing to launch a new business.

This is the group of “reasonable” entrepreneurs and the percentage of successful deals with them is very high.

➤ **Entrepreneurs willing to start an additional business.** They prefer franchising because it saves time and financial resources needed for long-term development of a business model.

➤ **Applicants without any business experience.** This group is willing to make benefits

of the strength of the brand and from the offered know-how for its managing.

➤ **Applicants, who are choosing EU funding for launching their own business.** This is a niche, which low cost franchising chains could use and could turn into national chains which is typical for the rural tourism.

➤ **Operating businessmen.** They move into an entirely new field or seek to develop franchise business model as a supplement to their ongoing business and endeavours. The reason is that a large portion of company owners suffered seriously by the crisis and want to diversify their capital and business experience into other sectors, which are not so much affected.

The franchising model offers developed know-how, necessary for launching business. A number of entrepreneurs are facing the dilemma either to struggle with the economic conditions to complete depletion of their financial resources or to move ‘under the wing’ of a big chain. During the past year in Bulgaria more often is practiced the so called conversion franchise. By its help, an existing business is included in a franchise system agreeing to operate under its name and rules, in return of payment of a fee.

In Bulgaria the average term of return of a starting investment in franchise business is 15 (fifteen) months, however it depends mainly on the franchisee’s skills and efforts. The majority of recipients of franchise entitlements believe that after the crisis despite of the low sales, those working under this model will have a higher market share than that of the independent entrepreneurs.

➤ **Average parameters of franchising in Bulgaria**

✓ Average fee, collected by the franchisors for starting a franchise business: approximately about EUR 3,000.

✓ Monthly royalty deposits: average 4.9 % of the turnover.

✓ Some franchisors fix a minimal fee for the use of a franchise (e.g. 5% of the turnover, but not less than EUR 250 per month), others (usually these are forms of a distribution franchise) don't require such a fee, but the franchisees are obligated to buy the goods offered from their franchisors only.

✓ Average fee for the national advertisement fund: 4.2 %.

✓ Total investment for starting a franchise business: about EUR 1 500.

✓ Number of outlets: average 11 outlets per chain.

✓ An average lease term: 5 years.

One of the **problems** related to franchising in Bulgaria is the **unregulated financing of the franchise projects**. Every particular franchisor has the commitment to negotiate with individual banks for financing of their project. There are no specialized bank products to be offered to the clients entering into franchise deals. According to many experts, franchise market in Bulgaria by its features is close to that of Greece. The current trend is associated with the introduction of more specialized franchise models, especially in the sector of tourism services. In support of this is the fact that in the past two years, the number of companies offering franchises in Bulgaria has tripled. The reasons for this are that the start-up investment returns in very short terms (from 1 to 3 years) and especially, the opportunity to follow a proven **business methodology**.

Another problem the franchise in Bulgaria is connected with **organizational and legal issues**. There is no legal regulation of franchise, neither in a separate legal document, nor as a part of the regulation on other matters. It is necessary to be established real competitive conditions between the franchise systems and the traditional mechanisms for sales of goods; the adopted legislative rules and regulations concerning the participants in the franchise system should provide convenience to them, and establish transparency in the system and its elements for the controlling authorities.

The lack of awareness of the franchising as a business concept is the major problem for its insufficient development in Bulgaria. The small and medium-sized enterprises are the most numerous and they have a great potential for flexible adaptation to the economic conditions in this country and to the changing market conjuncture. The enterprises in this sector are the most likely buyers of franchise.

For the period 1996 - 2012, in Bulgaria have been invested over 17 billion euros in tourism sector and hotel facilities have been built with over 1.2 million beds. So far, only 3.8 % of these hotels work with franchise agreements. New future of franchising is in the management of rural tourism, which is still undeveloped European and international practice.

Although the mentioned disadvantages, the franchise has established itself as a method of **business cooperation** with a significant lower level of risk, compared to a self-starting and developing of a separate business. In this dynamic economic period, the franchising has the potential and the ability to become the most profitable method for those entrepreneurs, who are willing to launch or grow their businesses.

FINDINGS

- Franchising is reviewed as an alternative growth strategy.
- Owners of franchise companies are not directly responsible for the financial investments.
- Responsible franchise system is the one that provides added value to its franchisees.
- Franchising is a method for fast growing and marketing distribution of products and services.
- Franchising is the new civilization level in tourism industry.
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CONCLUSION

The current financial and economic crisis is affecting all market sectors. A lot of tourism enterprises have prematurely chosen franchise as an alternative strategy for their growth and global integration. Other companies apply it following consultants and advisors, who in most cases are interested in the professional fees, rather than the long-term success of the franchise program. In Bulgaria the franchise is a mean to attract foreign expertise and financial capital. As a business form, the franchise has a significant importance for improving quality of servicing in tourism industry, acquiring know-how, getting closer to world standards and last but not least, generating an economic growth for the Bulgarian economy.

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