CHAPTER – I

INTRODUCTION

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Introduction

Although Franchising is in its nascent stage, franchising is gaining popularity in the retail segment in India, more particularly in the areas of food products and drinks, restaurant chains, consumer goods, and computer training centers. Franchising is one way in which a company can take advantage of India’s vast market with a degree of control that other traditional forms of distribution cannot match. It is now very important to understand the viability of this unique business model to India.

1.1 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. The franchisor provides training and continuous assistance to the franchisee.

1.2 Different Types of Franchising

Single-Unit Franchise
In a single-unit franchise system, one person buys a store from the main company and operates it according to the company's rules. Operating one store at a time is a good choice for new business owners. Some successful operators of one store eventually buy more stores.

Master Franchise
The master franchise is a popular way to spread American businesses to international territories. This method allows one entity to find many franchisees in an overseas area. The master franchisor is responsible for training and providing support to the new franchisees within the large area, which can include an entire country. Master franchisers often establish training centers for new franchisees.
1.3 Trends of Franchising

Trends of 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 operated sector wise, how much of it was organized versus unorganized and what proportion of total revenues was each of these segments contributing, sector wise. It is obviously clear and certainly believed that food, retail, education, services formed the core of Indian franchising while elaborating on how the entrepreneurial spirit in the country, coupled with the huge consumer class, availability of investment capital and the growth of several new concepts has been fuelling the growth of franchising in India. The consumers, franchisees, franchise consultants, government agencies and franchisors becoming important stake holders of the franchise model in India.

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 I began my career 10 years ago, I did see a lot of franchise companies failing, but now the failure rate has come down considerably. The failure I could see clearly was attributed to not understanding the far reaching effects of franchising not the franchise model itself as is generally the misconception. There are also occasional failures which we are able to anticipate but cannot do much as the franchisor is not willing to put in the resources or do things they are supposed to do to be successful. Outside (I mean clients who do not use reputed franchisor in India), where clients franchise themselves, we see a very good chance today of very second business that is franchised succeeding, which means that every second business is susceptible to failure, and that needs to be corrected as early as possible for franchising to grow organically, because as a democratic set up and the way India is culturally and geographically diverse there is no alternative business route which can be as comprehensive, relevant and as scalable as franchising is. We have several examples of different Indian companies like Titan, NIIT, Euro kids, Lakme and many others who have literally worked very successfully across the
diverse landscape of India and have become role models for their specific industry around which several other players have come into existence and are now growing at a rapid pace. Hence most of the established segments in franchising have role models or the top 2-3 players paving the way for smaller companies to learn from their peers and create their own niches and deal with the diversity of the Indian customer through a franchise strategy that gets them to their goals.

**Figure 1: Franchise Matrix**
1.4 History of Franchising – World Perspective

Franchising history

Franchising in France can be observed since the earliest years of the twentieth century, and gained momentum in the 1960s with the development of hypermarkets and the shopping malls that typically surrounded them. Franchising is a great business opportunity for people interested in investing or working on their own. And above all, the government of France recognises this sector as a potential source of development and employment. Franchising is actually booming in France and plays a vital role in the French industry for large, medium and small-sized companies. More than half of all French franchises are small to medium-sized companies.

Going further back to the early stages, the first franchising network of France came into being around 1911. The franchising history of France tells us about Jean Prouvost, owner of a wool mill in the Roubaix, who charged one of his employers with a responsibility to create a chain of wool shops. The employer created a sort of partnership between the wool mill owner and many traders, with an agreement to warrant them the patent of the brand. The brand was the famous "Laines du Pingouin" (Penguin Wools)! It is because of this event that the US and France vie with each other for the primacy of "franchising mother-country".

![Figure 2: History of Franchising.](image)
1.5 History of Franchising- India Perspective

As per earlier records and available data Ms. Shah an NRI arrived, on New Year’s Eve. She was so happy to know that the Indian economy had grown in the last quarter at 8.4%. She decided to go to the US to pursue her dream of running her own business late back in 1970, an era plagued by regulation and bureaucracy. Her business of selling Indian garments in the New York, US had been tremendous successful. In 2004, she was amazed to see the change in the Indian capital. She used the Hertz Rent-A-Car service for airport pick-up. She decided to stay at Orchid (a franchised hotel chain). For instant rejuvenation she dropped at Shehnaz Hussain Beauty Parlour. She had come here to set up a liaison office in India. Having no previous experience about doing business in India, she decided to avail the services of a franchised Business Service Provider, Crestcom. She was overjoyed when she came to know about the local Subway operating with the same American standards in India. She appreciated the food, as it tasted exactly the same as she had at the Times Square Junction, New York. She was glad that the Ritu Beri designed clothes are available in Delhi, and they are franchising at an international level. She knew that the clothes designed by her were a rage in the US and she couldn’t afford to miss this golden opportunity.

What one would notice is that all these companies have expanded gradually and made their presence by franchising. Franchising, as a way of expansion in India was little known till the 1990s. Franchising in the US was initiated by the fast food industry, whereas in India it was IT Education industry who led to its evolution.

Today, franchising has forayed into all industries from Food and Fuel to Lodging and Child Care. Technical, IT based franchising has also grown in India, Cartridge World, Abee Fill Cartridge Refilling Stations, Refeel, Sify iWay internet cyber cafes and many more. One of the major interesting facts is also to be understood that and earlier franchising business was introduced to only top 4 metros and state capitals but now every District Capital and Town is doing business under the franchisee model. More and more new business entrepreneurs and getting attracted by the franchised way of business due to their expectations for success and surety of business because of branded model and professional approach of business from franchisor.
1.6 Potential of Franchising in India

India is a geographical diverse country. Franchising in India is at a very nascent stage. However, this industry has clocked the growth rate of 25-30%, the second fastest growing industry. In the US, 45% of the sales come from franchised business; India is still to reach that stage, where franchised businesses are as widespread as the local grocer.

Franchising, as a dynamic and ever changing industry, will firmly establish itself in a couple of years. It is not difficult to spot malls. Organized retailing though only at 2% of the retailing, will take off in a very big way. The Indian middle class has been slowly expanding; it now buys consumer appliances, thanks to the economy growth of over 8, the stock market crossing 6,000, forex reserves surpassing 100 Billion USD, and the increase in disposable income. Today, over 33 million Indians can afford the best services and products and over 310 million Indians buy consumer appliances.

India offers lot of potential for the franchising community. Apart from Indians being very entrepreneurial, franchising as a way of doing business has been well accepted. Today, we can find international names like Gold Gym, Subway, and Hilton etc. The service sector which will open up in 2006 according to the WTO guidelines will bring in more opportunities for the Indian entrepreneur and a larger market for the franchisor.

With Goldman Sachs predicting that India will be the third largest economy in 2025 and S&P upgrading India’s credit standard, and an extremely stable government, the franchising community has a lot to cheer.

Sify iWay had aimed 5000 iWay franchised outlets in India and their intention was to open one franchisee per pin code of the country. If a small cyber café business unit can aim for such a huge franchised network then just imagine the scope of total business if done under franchising. Today each avenue of business and sector needs a professional way of doing business and franchising is supposed to be the best know model for a successful marriage of Businessmen + Professionals. There is endless scope for expansion and heights which franchising can attain if viability is proved.
1.7 Advantages of Franchising for Franchisor & Franchisee

The pros of franchise ownership

Buying a franchise can be a quick way to set up your own business without starting from scratch. But there are also a number of drawbacks.

• Your business is based on a proven idea. You can check how successful other franchises are before committing yourself.

• You can use a recognized brand name and trademarks. You benefit from any advertising or promotion by the owner of the franchise - the "franchisor".

• The franchisor gives you support - usually including training, help setting up the business, a manual telling you how to run the business and ongoing advice.

• You usually have exclusive rights in your territory. The franchisor won't sell any other franchises in the same region, though there will be competition from other businesses.

• 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.

• You don’t have to start a business from scratch. A skeleton business model is available, which you just need to fill up with your hard work and understand how the system works.

• The franchisor will help you at every step when you start a franchise business.

• The franchisor will provide you an estimate of how much money you will need to buy a franchise from it.

• Finding an investor, who is willing to invest in a business venture of a novice, is quite difficult. But with franchising, it’s not a problem, because the name of the franchisor acts as guarantor for the new franchisees.

• The bulk purchasing power of a franchise system ensures that you get discounts from manufacturers.

• Developing a market position takes a long time; but with franchising, it comes easily as you are marketing the already established brand-name of the franchisor.
1.8 Disadvantages of Franchising for Franchisor and Franchisee

The Cons of franchise ownership

• Costs may be higher than you expect. As well as the initial costs of buying the franchise, you pay continuing royalties 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.
• One’s freedom as an entrepreneur is restricted when one is a franchisee. Your franchisor may dictate you in almost everything, starting from when you open your store and what you can sell to what will be the design and color of your store!
• 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 be out of sync with the local market and force you to adopt policies that are counter-productive.
• Your franchisor may force you to buy products from suppliers at higher prices than the market-rate.
• Joining hands with certain franchisors can be damaging, as they may have a restrictive non-compete clause, if you terminate or don’t wish to renew your franchise agreement.
• A high royalty fee may eat into your profit margin. When it comes to pay ongoing royalties and advertising fees along with the initial franchise fee it becomes a nightmare if the cash flows and the expenditures are not properly monitored.
• The public image of your business can be damaged if other franchisees are performing poorly or the franchisor encounters problems.
• The parent company or franchisor you sign a franchise agreement with has the right to control a large portion of your operational decisions, including setting prices for goods or services, determining location decor and mandating employee uniform requirements. These constraints rob you of the chance to put your own
stamp on your franchise location. This may make you feel like less of a small-business owner because you don't truly have total control over your company. In the end, you have to adhere to the parent company's demands to preserve your franchise agreement.
1.9 Government, Financial, FAI Role on growth of franchising in India

An important part of our discussion was what role the government should play in promoting the success of franchising business model in India. We then moved on to how can financial institutions in India provide impetus to the franchising model in India and what can organizations like FAI do to develop franchising in India. Here again researcher strongly believes that the government should grant franchising a specific segment status like it has done for say industries or agriculture. Today there is no pure franchise related funding assistance provided despite the fact that banks and bodies like SBI, SIDBI etc. say that they provide loan for franchising, but in effect it is all done on the basis of the person applying for the loan rather than the merit of the business itself or a combination of both. We cannot go to a bank saying that here is a credible profile, and this is the business that he or she wants to pursue, please sanction the loan for the same, as the business has a track record of success and this will ensure that your chances of recovery will be very good instead of the institution just merely looking at the repayment capability of the profile irrespective of what the franchise is. Being not very regulated has its own advantages as it provides an ecosystem for smaller companies with lesser resources to grow and cuts off the red tapism and other government interventions. However, the flip side is, there could be unscrupulous players taking advantage of this situation. Today several international companies who look at India feel that there is not enough regulation in India to support the growth of their business and when we help them understand that corporate India definitely has a very good legal framework, which when used properly from a franchising perspective, can ensure that they are able to operate very efficiently. In fact having a local master franchise who understands very well can only translate into running the business efficiently. See the case of Dominos or McDonalds in India, with their master franchises being local and from a corporate background, helping the franchisor to scale up the business to such high levels within a very short time.
1.10 Franchising Challenges in India

How difficult is it for franchisors to convince franchisees of business viability, returns and the brand and its quality. For me 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. They generally compromise on their initial franchise marketing budgets, are always relying on somebody to take up their franchise and put the money on the table, irrespective of where they came from or what their profile was. From there we chatted on how franchisors found it difficult to maintain the brand and quality standards, maintaining stock at agreed levels, payment related concerns, royalty receipts, disclosure of sales and business and recruitment of skilled employees by the franchisees. We then discussed how franchises faced challenges on location, rentals, recruitment of the right talent, retaining employees and the capital constraints they face when businesses had a down cycle and how that impacted the franchise brand in the long term.
1.11 Franchisee Attrition

Finally we discussed why franchisees leave a franchise system by understanding the Disadvantages of the Franchisee system? It is most commonly observed that the most obvious reason for franchises to quit is they do not get the expected financial returns. When they see that they are not getting the required marketing, operational, technical and other support they switch off. At times it is also observed that some franchises have to leave due to personal problems or their relationship with the franchisor has soured or there has been a change in regulations or ownership/possession of properties where the business operates or their ownership patterns itself changing, which impacts the business. At times franchises also leave when they have found something more lucrative or have got themselves a better franchise. It is also seen at times, that franchises become franchisors, when they believe that they can create a similar business and earn more from being a franchisor, hence planning an exit to re-enter the same business as a franchisor.
1.12 Need of Research on this Topic

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.

In continuation to the findings from past research, this study will help to provide insights on the reasons for choosing franchising as a viable business model.

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 of the city of Pune.

Though Franchisee is gaining fast popularity in the Indian Market, it is very crucial to understand the profitability of these models and the actual implication of the business onto the profitability, ROI, BEP analysis in necessary.

The study will analyze whether lower failure rates of franchises are one of the main selling arguments for attracting potential franchisees to the system. But, are the failure rates really lower? Is the franchising promise true? The empirical evidence is not clear.
1.13 The Aims and Objectives of the present research

The proposed study will attempt to address many aspects of franchising in order to contribute to the knowledge about Franchising Business Models for both readers and prospective franchisee takers.

The main objectives of the study, therefore, are:

1. To study various franchisee models currently prevailing in the market of the sample size selected for study.
2. To personally meet the actual franchisee owners and collect primary data for analysis and analyses it to generate expected outcomes.
3. To check the success and failure factors for the franchisee.
4. To generate a Franchisee buying guide for the layman who aspires to buy a new franchisee.