CHAPTER 2

FRANCHISING

2.1 INTRODUCTION

"The word franchise means privilege or freedom and in this sense it offers people the freedom to own, manage and to direct their own business. It means being in business for yourself but not by yourself' (FASA franchising brochure).

This chapter will provide an overview of franchising. The aspects that will be discussed are the definition of franchising, the parties involved in franchising, the types of franchising, the history and meaning of franchising, international and national statistics as well as the benefits, disadvantages and literature available on the subject.

2.2 DEFINITION OF FRANCHISING

It is not an easy task giving a single definition of franchising. There are many different types of franchising, each with its own unique qualities, benefits and characteristics (which will be discussed later in the chapter).

Stanworth and Kaufmann (1996:57) try to explain what differentiates franchising from other business forms by stating that the ingredient that separates franchising from most other forms of business activities is the symbiotic relationship of inter-dependence which exists between legally distinct economic entities.

Elango and Fried (1997:68) state that *"franchising is an organisational form in which a company grants an individual or another company the right to do business in a prescribed manner over a certain period of time in a specified place in return for royalties or the payment of other fees"*

Various other authors try to explain franchising by the common characteristics that franchising businesses possess and that separate this type of business from any other form of business.

2.2.1 The characteristics of a franchise

Franchise businesses usually have the following three aspects in common:

- *"The franchisor is in the business of selling franchises to independent third party local operators to market a product or services under a method created by the franchisor;*
- *The business is based upon a common method or approach, that relies on a combination of techniques or products plus the franchisor's special trademark, service mark, trade name, logotype, advertising, or other symbol that designates the franchisor; and*
- *The franchisee is required to pay fees and conduct its local business in a manner meeting the franchisor's requirements* (Anon, Franchise Law at FreeAdvice.com 1998).

According to Maitland (1991:1) all ethical franchises should have the following distinguishing characteristics:

- The business format is comprehensive and complete.
- The business format is established and has been proven successful.
- The franchisor offers help, advice and support to the franchisee to start the business in accordance to the business format.
- The franchisee pays an initial fee to the franchisor.
- The franchisor gives continuous support and guidance to the franchisee.
- The franchisee receives an operating manual from the franchisor.
- The franchisee pays a royalty fee or management service fee on a continuous basis to the franchisor in return for back up services.
- A binding franchise agreement should be drawn up and signed by both the franchisor and franchisee.

- The franchisor and franchisee are legally independent of each other, owning their own businesses, which they are free to sell as and when they want (subject to contractual obligations between them).

Mendelsohn (1992:16) summarizes the basic elements as follows: There must be:

- A contract
- A system developed
- Training
- Continuing support
- The grant of the right to operate a business using the systems and branding
- Substantial capital investment from the franchisee
- Ownership of the franchise by the franchisee
- Payment for rights

2.3 THE MAIN PARTIES IN FRANCHISING

Maitland (1991: 1) states that "*franchising involves one party developing a successful business format, which is then licensed to another party to set up and run a wholly identical venture in a particular area for a specific period of time. The party granting the licence is known as the franchisor. The licence is called the franchise.*"

A **franchisor** is a company or person that owns a brand name, trademarks, operating systems and support systems and that grants an independent operator the right to distribute its trademarks, products, services and techniques (http://www.FreeAdvice.com/law/515us.htm 1998).

The **franchisee** is the independent business person that distributes the franchisor's products or services through retail or service outlets (http://www.FreeAdvice.com/law/515us.htm 1998).

"The franchisee is delegated the right to use the brand name in a defined market, for a designated period of time, to develop a market share for the franchise system" (The Franchising Handbook 1993).

Franchising is an interdependent relationship where responsibility is shared between the franchisee and the franchisor. Franchisees are usually close to the final customer, which would make the franchisee better suited to specific types of jobs than the franchisor. The franchisor on the other hand is usually much larger and can therefore make use of economies of scale and pass the benefits obtained to franchisees in the system (The Franchising Handbook 1993:67).

It is important to realize that a franchisor cannot "sell" a franchise to a franchisee, but rather "grant a license" to the franchisee (The Franchising Handbook 1993:11). If a franchise is sold, it would mean that a franchisee could change any part of the concept, operating procedures etc, because he/she would "own" the business. This statement is supported by the following facts:

- *"A franchisee cannot incorporate using the franchisor's name because the franchisee does not own the name.*
- *Should the franchisee want to exit the business, the franchise license is not sold: rather, the franchise license is transferred upon approval of the franchisor. The franchisee enters into a separate transaction to sell her assets.*
- *The franchise agreement has a stated term and must be renewed if the franchisee is to continue in business under the franchisor's brand name. If a franchisee owned the license, it would not need to be renewed."* (The Franchising Handbook 1993).

The **outlet / establishment** where the franchising operation is conducted is called a franchised unit. A franchisor usually has a number of franchised units, some which are owned by franchisees and others which are owned by the franchisor and run by its employees (called company-owned units). A "franchising system" refers to the franchisor and both franchised outlets and company-owned outlets (Elango and Fried 1997:69).

Different types of franchisees also seem to exist and in the following section the types of franchisees are briefly described.

2.3.1.1 Types of franchisees

- **Single franchisee**

  This refers to an individual businessman (franchisee) that owns and runs a single small outlet on a day-to-day basis. This franchisee can however also own more than one outlet.

- **Multi-unit Franchisee**

  Companies that own many franchised outlets without being actively involved in their day-to-day management are called multiple franchisees. These companies (franchisees) will hire managers to handle the daily management of the outlet. The multiple franchisee will have other business interests besides the franchises although the multiple franchisee will have a large financial investment in the franchise system as a whole.

- **Area Franchisees / Master franchise rights**

  The franchisor sells the exclusive franchise rights in a given territory to an "area franchisee" also called a master franchisee / developer. The area franchisee can then either sub-franchise to other franchisees or open and run franchises in this area himself (Hall and Dixon 1988; Turner in the Franchising Handbook 1993:461).

Just as there are different types of franchisees, there are also different types of franchising. The next section attempts to shed more light on the different types of franchising.

2.4 TYPES OF FRANCHISING

There are numerous types of franchising which will be discussed in this section, although only one of these types (namely "business format franchising") is really relevant for our study (because our study was confined to franchise systems that qualified as being "business format franchises"). The other types of franchising and there definitions are included for the sake of completeness.

It is important to note that in all types of franchising the two parties involved are legally independent of each other. Hall and Dixon (1988:13) state that a fundamental requirement of a franchise is that the franchisee and franchisor are legally independent. They further state that most franchise agreements clearly affirm that franchisees are not agents or partners of the franchisor and therefore have no authority to represent themselves as being the franchisor's agent. The franchisor can therefore not be held responsible for the actions of the franchisee.

2.4.1 First Generation (Also called Traditional Franchises / Product and Trade name franchising)

2.4.1.1 Licenses

Hall and Dixon (1988) define a licensing agreement as "....*one which confers on the licensee the right to manufacture, sell, or use something which is the exclusive property of the licensor."* A license agreement usually lasts for a specific period and pertains to a specific territory. The licensee pays the licensor a royalty fee for the right to manufacture, sell and use the licensors property. According to Mendelsohn (1992:37) this type of franchising involves a transaction between a manufacturer and a wholesaler, for example, a bottling company.

Although licensing and distributorship arrangements are usually included under the concept of franchising (and sometimes even used interchangeably with the term franchising) there are subtle differences. Licensing tends to be more "clear cut" with fewer conditions placed on the arrangement, while "business format franchising", places more controls on both the franchise and the franchisor (Nathan 1993).

2.4.1.2 Distributorship (or dealership)

In a distributorship agreement the *"...manufacturer grants the distributor the right to sell the manufacturer's products within a given area."* (Hall and Dixon 1988:12). Distributors are usually required to maintain specified standards and the corporate image of the manufacturer. Minimum stock levels and the exclusive sale of the manufacturers products are sometimes also required.

These types of transactions are usually formed between manufacturers and retailers (Mendelsohn 1992:38).

2.4.1.3 Right to use a trade mark

The franchisor (also the owner of a trademark) grants the right of use of the trademark to a franchisee in return for the payment of fees. The trademark remains the property of the franchisor (Hall and Dixon 1988).

2.4.1.4 Concessions

According to Hall and Dixon (1988) there are two types of concessions, namely:

- The right to trade in a given location. An example of this is catering rights in an airport. Franchisees obtain the right of trade in return for an initial fee as well as royalty fee payments.
- The right to sell a product (s) within an existing retail outlet.

2.4.2 Second generation franchises

2.4.2.1 Business Format Franchising

The International Franchise Association defines a full "business format franchise" as follows: "*A franchise operation is a contractual relationship between the franchisor and the franchisee in which the franchisor offers or is obliged to maintain continuing interest in the business of the franchisee in such areas as know-how and training, wherein the franchisee operates under a common trade mark, format or procedure owned or controlled by the franchisor, under which the franchisee has or will make a substantial capital investment in his business from his own resources.*"

According to the International Franchise Association Educational Foundation and Horwath International, business format franchising is characterized by "*an ongoing business relationship between franchisor and franchisee. This includes the product, service and trademark, as well as the entire business concept itself – a marketing strategy and plan, operating manuals and standards, quality control, and a continuing process of assistance and guidance*" (Goncalves and Duarte 1994:30; Friedlander and Gurney 1990:3). Fulop and Forward (1997:603) agree with this and state that business format franchising entails a more integrated relationship between parties compared to other forms of licensing.

Typically "business format franchising" includes granting the use of a name or logo, maintenance and continuing control over the manner in which the business is run as well as an obligation for the franchisor to provide ongoing assistance to the franchisee. The franchisee in turn is responsible for the payment of fees to the franchisor for goods or services and the use of the name and image (Nathan 1993).

Hall and Dixon (1988) agree with the above-mentioned statements by saying that most "business format franchise" provides the franchisee with a total package including training, trade marks, logos, design and layout of premises, standard furnishings, colour schemes, marketing plans, operating systems and continuous advice. The franchisor therefore has control over every single aspect of the franchise from pricing, to quality of services and even hiring and training practices.

2.4.2.2 Types of Business Format Franchising

Maitland (1991:3) suggests that there are three types of "business format franchise" categorised according to the size or level of investment needed to establish the operation. The types of franchises are detailed below:

- **A job franchise**
  This is a small franchise ideal for a person who wants to start a business on their own. It is usually run from home or a van and the capital investment is relatively low. Minimal stock and equipment is needed and a modest income is usually derived.

- **A business franchise**
  This type of franchise is popular with husband –and – wife teams (or their equivalent). Products and services are sold from commercial premises such as a shop or office and this franchise is therefore a more costly and substantial concern. The rewards (income) from the business franchise should be higher than from the job franchise.

- **An investment franchise**
  A company looking for a long-term return on investment would most likely purchase this type of franchise. The capital expenditure is astronomical and the financial returns are usually very lucrative.

Stecker (in The Franchising Handbook 1993:466) state that the simplest form of a "business format franchise" is that of direct franchising of individual outlets across different regions.

2.4.2.3 Characteristics of business format franchises

Hall and Dixon (1988:18) state that the following are the basic elements of a "business format franchise" agreement:

- A detailed contract will contain all terms, conditions and responsibilities of the parties that are involved.
- The franchisee will have a defined territory for a specified period of time.
- The franchisor will provide an entire business concept.
- The business concept will have been tested and proved to be successful.
- The franchisee will be trained by the franchisor on all aspects of running the business.
- The franchisor will provide continuous support to the franchisee.
- The franchisee will benefit from the goodwill, which has been built up by the franchisor.
- The franchisee will pay an initial fee as well as royalty fees.
- The franchisee will make a financial investment in the business and also be involved in the day to day managing of the business.
- The franchisee will own the business and is legally independent of the franchisor.
- Franchised units will be identical as far as possible in terms of appearance and services offered.

2.4.2.4 Conversion franchises

This type of franchise occurs when the franchisor convinces an independent business-person that owns a business in the same industry, to convert their current business into a franchise. The business person contributes by investing their property and expertise, while the franchisor contributes by providing the trade mark and operating procedures (Hall and Dixon 1988).

2.5 BENEFITS AND DRAWBACKS OF FRANCHISING

Franchising a business has definite advantages and disadvantages for both the franchisor and the franchisee. This section is aimed at clarifying the benefits and drawbacks for both parties.

2.5.1 Benefits for franchisors

According to Maitland (1991:13) the benefits of franchising for a franchisor is:

- **Low capital expenditure**

  The franchisors initial expenses should only include the organizing and marketing of the franchise system, thereafter the set up and running of the operations is done with the franchisee's money.

- **Personal commitment and motivation**

  Franchisees invest time, money and dreams in the franchise. Franchisees usually have a lot at stake when obtaining the rights to a franchise and they often have loans to re-pay and failure would mean bankruptcy. This makes franchisees have a high degree of commitment and motivation, as well as harder working than any manager that might be appointed.

- **Reduced daily involvement**

  Franchisees are responsible for the daily management and running of a franchise business. The franchisor is therefore free to give attention to the growth of the franchise system by attracting and selecting new franchisees and improving the business concept.

Hall and Dixon (1988:40) identify the advantages of franchising for franchisors as follows: Franchisor can achieve rapid expansion of their distribution system while spreading the risk of a major expansion programme through franchising. Franchisors are also able to compete on equal terms with larger rival companies and franchisors are therefore able to use their negotiating strength to the benefit of franchisees. Franchisees are responsible for the daily management of the franchise (which reduces the burden of the franchisor) and because franchisees make a financial investment in the franchise they are usually highly motivated and operate / manage the outlet for a longer period of time than hired managers would. Franchisees usually have a better knowledge of the local market than hired managers, which would make the business more profitable. Franchising also reduces the problem of managing outlets in remote areas and franchised outlets may also be more viable in "marginal" areas / locations where company owned outlets would be uneconomic.

2.5.2 Drawbacks for franchisors

Maitland also identified various drawbacks of franchising for franchisors. The three main drawbacks according to Maitland (1991:16) are:

- **Loss of ownership**
  Eventhough the business concept belongs to the franchisor, the concern itself belongs to the franchisee. The franchisor-franchisee relationship is therefore different from that of the employer-employee relationship.

- **Low profits**
  A franchisor will usually receive a lower income from a franchised outlet than from a self-owned unit.

- **Interdependence**
  Both the franchisee and franchisor have certain responsibilities. The franchisor should provide a tried and tested business system with continuous help and support for franchisees. Franchisees should follow the operating manuals, maintain the good name of the franchise and pay royalties on time. If either of the parties does not honour their respective responsibilities, the whole franchise system will suffer.

Further drawbacks of franchising for franchisors are that the objectives of franchisees regarding profit, turnover and corporate image may not correspond to those of the franchisor. The franchisee might also become resentful of the controlling nature of the franchisor, which will lead to a break-down in the relationship. The franchise contract only allows the franchisor to end the relationship in certain circumstances and changing a franchisee is a very difficult exercise. Franchised outlets may also be less profitable than company owned outlets in certain circumstances (Hall and Dixon 1988).

2.5.3 Benefits for franchisees

Maitland (1991:69) states that the major advantage of franchising for franchisees is the fact that franchises usually have a proven track record with an established name, which leads to immediate goodwill. Help and support is also available with the launch of the business and ongoing support is provided. This help and support leads to fewer mistakes, less time being wasted on finding the best way of running the business and therefore, lower costs. Franchisees can also make use of group research, buying and advertising arrangements.

Hall and Dixon (1988:36) recognize the benefits mentioned by Maitland as well as the following; franchisees usually don't require previous experience, the chances of success are higher than with an independent business and the chances of raising finance is therefore also much higher. Franchisees are protected from competition with other franchisees and site selection is done by the franchisor. Start-up cost and operating costs of franchises are also lower than independently owned businesses.

2.5.4 Drawbacks for franchisees

There are also drawbacks for franchisees when considering the franchising option. A franchise business is hard work and effort and should not be seen as a get-rich-quick scheme. Constant franchise fee payments must be made to the franchisor in return for advice and support. A franchise is also based on rules and procedures that must be followed and sometimes this can lead to frustration on behalf of the franchisees. The franchisee and franchisor are dependant on each other and if the franchisor doesn't perform the required tasks, the franchisee will suffer (Maitland 1991:73).

A further drawback of franchising for franchisees is the high degree of control that is exerted over the franchisee by the franchisor. Although this control is necessary for the survival of the franchise, it may lead to power struggles in the relationship between franchisees and franchisors. The franchisees' business might also suffer because a franchisee is unable to make adaptations to the operation as local tastes and circumstances change. Bad publicity surrounding a franchisor will also have a negative impact on the franchisee. Furthermore, the franchisee is obligated (and contractually bound) to continue to operate the outlet and termination of the relationship may be very restrictive (Hall and Dixon 1988:39).

2.6 HISTORY OF FRANCHISING

According to Cherkasky (in The Franchising Handbook 1993:1) the modern concept of franchising emerged in the USA after the Civil War with the Singer Sewing Machine Company being the first to establish a network of salesmen and dealers to distribute its sewing machines. Mendelsohn (1992:19) agrees that the modern concept of "business format franchising" started with the Singer Sewing Machine Company.

Hall and Dixon (1988:4) however state that franchising emerged in Britain during the Middle Ages when church officials would pay the government for the right (i.e. the franchise) to collect local taxes. This form of franchising ended in 1562 when the tax collection procedures were reformed.

Franchising resurfaced again in the eighteenth and nineteenth century when a legislative body or "royalty" would grant the right to a long-term monopoly in some form of trade or commerce to a franchisee. The franchisee paid royalty fees and had certain obligations to fulfil. The next step in the development of franchising came with the "tied house" agreements between breweries and landlords. Breweries would purchase premises with and alcohol license and then lease these to landlords; in exchange the landlords would only sell beer from the specified brewery (Hall and Dixon 1988:4).

Mendelsohn (1992:19) however states that the pub-tied house agreements were merely "exclusive purchasing agreements" and could thus not be seen as true franchising agreements.

According to Hall and Dixon (1988:4-6) franchising in the United States started in the automotive industry with the granting of exclusive territories to franchisees. Car dealership franchises were fully established in the United Stated by 1910. The soft drinks bottling industry followed by granting the right to use the packaging and brand name of the franchisor to a franchisee (bottling plant). The third major industry to use franchising was the petrol industry. The abovementioned types of franchises have become known as traditional or first generation franchises.

Goncalves and Duarte (1994:30) state that product and trademark franchising were the first types of franchising to gain acceptance as being viable. The real franchise boom however, started in the 1950's with the appearance of business format franchising (also known as second generation franchising).

2.7 PERSPECTIVES ON FRANCHISING

There are many perspectives on franchising and this section will aim to inform the reader of some of these perspectives.

Brown and Dev (1997:37) state that the basic premise of franchising systems is the fact that they enable member firms to perform at otherwise unachievable levels.

2.7.1.1 Franchising as a business strategy and marketing system

Kirkham and McGowan in The Franchising Handbook (1993:10) state that franchising is a business strategy with the aim of attracting and retaining customers, and a marketing system that creates an image of the company in the mind of customers. They conclude that it is also a method of distributing products or services that satisfy customer needs.

Friedlander and Gurney (1990:20) agree and state that "*franchising is a system or method of marketing a product or service.*"

Mendelsohn (1992:1) feels that franchising is a method of marketing goods and services and should not be seen as an industry.

2.7.1.2 Franchising as a distribution network or channel

Franchising is seen by some as a distribution network. A franchise business is a method of distribution used by companies to distribute their products and services through retail outlets owned by independent third party business operators (Anon, Franchise Law at FreeAdvice.com, 1998). According to Fulop and Forward (1997:603) business format franchising has become an alternative method of distribution and business development.

Fels in (Friedlander and Gurney 1990:21) also says: "*Franchising today is one of the most innovative, dynamic and effective systems for distribution of goods and services the world has ever know.*"

Williamson, Stern and El-Ansary (in Fulop and Forward 1997:603) identify franchising as a hybrid form of "vertical marketing system" and therefore a method of marketing goods and services dependent on complex contractual agreements. The view and implications of franchising as a vertical marketing system is discussed in more detail in chapter 4.

2.7.1.3 Franchising as a method of expansion

One of the most debated topics in franchising literature is the reason why firms choose to franchise rather than expand through company owned units. There are three main theories that attempt to answer this question and these theories will now be addressed.

The first theory is that of "resource scarcity" in which franchising is used to access resources needed for growth. Oxenfelt and Kelly (1968-1969) were the first to propose a life cycle model of franchising. In this theory, a young company, with limited capital, becomes a franchisor in order to use a franchisees capital to expand. As the franchisor acquires more capital, the franchisor might start to take back some of the larger units of franchisees. This view has become known as the "resource scarcity" theory (Fulop and Forward 1997; Hunt 1972; Caves and Murphy 1976; Combs and Castrogiovanni 1994; Sen 1998). Although this theory sheds some light on the question, it doesn't explain why companies with sufficient capital would still franchise their businesses (Elango and Fried 1997:69).

"Agency theory" is the second theory which attempts to explain the reason for franchising. This theory is based on the comparison between the cost of monitoring a franchisee and the cost of monitoring hired managers (Combs and Castrogiovanni 1994). The theory suggests that franchisee-owned outlets will perform better than company-owned outlets. According to Lillis, Narayana and Gilman (1976) the most important advantage offered by franchising is the high level of motivation of franchisees compared to paid employees. Fulop and Forward (1997:608) state that the "Agency theory" views franchising as a form of channel management which attempts to gain the advantages achieved by the corporate marketing vertical system (such as standardisation, economies of scale and control) as well as the advantages associated with independent businesses such as motivation, personal service and flexibility.

Risk spreading is another theory that has received some attention in literature. This theory proposes that franchisors give more risky locations to franchisees while maintaining ownership of less risky locations (Combs and Castrogiovanni 1994).

Although these theories are the most widely discussed, they raise many questions and counter arguments. Combs and Castrogiovanni (1994:41) state that none of these models have been able to account for a large portion of variance.

2.8 CURRENT STATE OF FRANCHISING

Now that the concept of franchising is understood (definitions, types of franchising, parties involved and the history of franchising) it is also necessary to know what the current state of franchising is on a national and international level. As will be shown in the next sections, franchising plays a very important role in the economy of several countries and has the potential to play an even greater economic role in the future.

2.8.1 International franchising situation

Franchising has played a significant role in the development of the economy of the United States and Britain (and many other countries), creating employment for millions of people. The contribution of franchising to economic growth, and the future growth of franchising is considered in the following section.

2.8.1.1 Growth and Importance of franchising

According to Mendelsohn (1992:20) when one examines the growth of franchising, the USA must be the starting point because the USA is the centre of modern franchise development and also provides the best statistics.

In 1993, franchising in the United States already accounted for 35 percent of all retail sales in the United States, which is more than $758 billion. More than 7.2 million people were employed by 542 000 franchised businesses from sixty different industries. It was calculated that a new franchise opened in the United States every sixteen minutes and that this growth rate was six times faster than the growth rate of the US economy as a whole (The Franchising Handbook 1993:4-6). Franchising also accounts for 10 percent of the Gross National Product in the United States and expanded by around 300 percent between 1975 and 1990 according to Horwarth International (in Fulop and Forward 1997:604; Stanworth 1995:3). Stanworth (1995:13) states that these figures are misquoted and that the inflation adjusted figures are more correct. If the inflation-adjusted figures are used, the average annual growth rate drops from 9.4 percent to 3.1 percent and the overall growth figure declines from 284.6 percent to 58.5 percent.

In Britain, the number of franchise systems rose from 170 in 1984 to 253 in 1987 and then to 379 in 1990. This meant that franchised units increased from 7,900 (1984) to 15,000(1987) to 18,620 in 1990. The gross turnover of the franchising industry also increased from £0.85 billion in 1984, to £3.1 billion in 1987 and then to £5.24 billion in 1990 (Maitland 1991:5-7). Fulop and Forward (1997:604) state that (according to the British Franchise Association) approximately 396 "business format franchises" existed with 24,000 outlets employing 185,000 people and generating an annual turnover of approximately £5 billion in 1993. An attempt was made by the BFA to compare US and UK statistics. From this comparison it was estimated that the franchising sector in the UK accounted for 29 percent of total retail sales (although various other authors suggested estimates ranging from one to ten percent).

2.8.1.2 Future growth of franchising

The franchise industry shows no signs of slowing down. According to Cherkaksy (The Franchising Handbook 1993:5) the following six trends will influence the growth and expansion of franchising:

- Sales growth of franchise outlets in the traditional franchising fields such as fast food, convenience stores, hotels and rental companies will slow down.

- Service type businesses / franchises will experience continuous, rapid growth and expansion and will become dominant in the marketplace.
- Large chains will continuously merge with and acquire smaller chains.
- Independent businesses will convert to franchise businesses.
- Globalisation of franchising.
- Ownership and management of franchise companies will be increasingly mature and diversified. As franchise companies grow the management style will become more corporate and less entrepreneurial.

Stanworth (1995:22) also identifies a number of factors that are likely to promote the growth of franchising such as the decline of traditional manufacturing industries and their replacement with service industries which are more suited to franchising, the increase in popularity of self-employment, higher employment rates for females increasing the need for home services (cleaning, domestic household services, house-and garden care) which is also very well suited to franchising.

2.8.2 National franchising situation

The concept of franchising is also well established and accepted in South Africa and has had a significant impact on the economy (as will be shown in the next paragraphs). The potential for franchising to have an even greater impact on the economy is also a possibility with the government considering to use franchising as a method of empowering previously disadvantaged individuals.

2.8.2.1 Growth and Importance of franchising

According to Gordon (The Franchise Factor 1998-1999) the franchising industry in South Africa grew from 173 systems in 1994 to 236 systems in 1995 to 398 systems in 1998, which equates to an increase of 162 franchise systems since 1994. The annual growth of franchising systems in South Africa according to Gordon (1998-1999) since 1994 was 32.5%.

Approximately 11 new outlets per franchised system were opened in 1998 with an estimation of the number of outlets in operation in South Africa calculated at 20,885. The average annual increase in the number of outlets since 1995 was calculated at 39.25% (The Franchise Factor 1998-1999).

The largest business categories (in South Africa for 1998) in terms of the number of franchised systems are automotive products and services (11.1%), education and training (11.5%), fast food (15.1%) and retail (15.9%) (The Franchise Factor 1998-1999).

The total turnover of the South African Franchise sector increased from R9,278 billion in 1994 to R21,791 billion in 1995 to R39, 969 billion in 1998 (excluding petroleum retail). This translates to an average annual growth rate of 54.6% since 1994. The franchising sector also provides jobs to a total of 266,104 people. (The Franchise Factor 1998-1999).

According to Ian Lourens (Chairman of FASA) the franchise growth rate in South Africa is 39,4 percent per annum, which translates to 12 percent of retail sales and close to R40 billion (IFE 2000 Visitors guide 23-25 March 2000).

According to Scholtz (1996:4) there are numerous reasons for the continuous growth of franchising in South Africa (from 1994 onwards) including the South African economy (which showed the lowest inflation rate, the highest business confidence index and a high economic growth rate for the 1994 – 1995 period). Other factors that played a positive role in the development of franchising are said to be the population composition (number of households belonging to the middle and upper middle class), the growth and role of FASA (Franchising Association of South Africa), the regulatory environment (few laws to regulate franchising for example the registration of a franchise is not compulsory and neither is disclosure documents) and sufficient patent and trade mark protection (adequate legislation is provided to protect franchising companies).

The lifting of international sanctions probably also had an effect in the growth of franchising in South Africa, with companies such as McDonalds and Sweet

Factory opening franchises in South Africa and some South African franchise systems (Nando's, Steers Fast Food, Spur Family Restaurants) expanding internationally.

Zeidman and Feirman (1995:50) agree that the South African business climate has been very inviting to franchisors with the abolition of apartheid, the lifting of economic sanctions, political reform and the development of a program aimed at black entrepreneurs.

2.8.2.2 Future of franchising in SA

As indicated by the research done by Gordon of Franchize Directions (in the Franchise Factor 1998-1999) the number of franchise systems, outlets and contribution to South Africa's turnover is likely to increase as the popularity of franchising increases in South Africa.

There are however a few aspects that should be addressed in the near future to ensure the prosperous future of franchising in South Africa. One of these aspects relates to a report from the Competition Board of the South African Ministry of Trade and Industry, which identified possible restrictive practices contained in franchise agreements. According to Zeidman and Feirman (1995:50) the following items may constitute restrictive practices;

- A franchisee may purchase stock only from the franchisor or from a supplier indicated by the franchisor,
- A franchisee may only stock or deal in certain types of products or services,
- A territorial restriction on the franchisees right to trade,
- A restriction on the franchisee dealing with customers outside a particular area etc.

It is clear that the aspects mentioned above are essential to running a successful "business format franchise". If the franchisor cannot prove that there are "overriding public interest considerations" to allow the restrictions mentioned above, the restrictions will be declared unlawful and will become unenforceable

(Zeidman and Feirman 1995:53). This could have a serious impact on the franchisor and the running of the franchise business. The uncertainty created in the franchising industry by this report and the implications thereof could have a detrimental effect on the growth of franchising in South Africa.

Another aspect that should be addressed is the Code of Ethics and Business Practices that has been adopted by FASA. The code is a mechanism for self-regulation with the basis of the code being a pre-sale disclosure document with a seven-day "cooling-off" period following the disclosure. Although the aim of the code is a noble one, a problematic aspect surrounding the code is that "*it appears to grant franchisees a private right of action for damages or annulment of the franchise agreement if the disclosure document is inaccurate or incomplete or the waiting period is not observed*" (Zeidman and Feirman 1995:53). Franchisors might start to ask how the code (which is meant to be self-regulatory) gives a private right of action to franchisees, which could again negatively influence the whole industry if this aspect isn't addressed and rectified.

It is evident that franchising has played a major role in the economies of many countries and that the future of franchising in South Africa has tremendous potential if managed correctly.

2.9 REVIEW OF OTHER FRANCHISING RESEARCH

Research on franchising has focused on aspects such as the nature of franchising and the reasons for franchising. This includes the existing theories related to the subject namely, the "resource scarcity theory", the "agency theory" as well as "risk spreading theories" (Elango and Fried 1997; Oxenfeldt and Kelly 1968-69; Carney and Gedajlovic 1991; Combs and Castrogiovanni 1994; Fulop and Forward 1997).

Research focusing on the growth rates of franchising (and the apparent creation of unattainable expectations based on misquoted information) was done by Stanworth (1995). Lafontaine and Shaw (1998) also did research on this topic.

The role and impact of international franchising strategies have also received attention in franchising research (Elango and Fried 1997; Connell 1997)

A considerable amount of research on the perceptions (and misconceptions) as well as statistics regarding failure rates of franchise systems and the reasons for failure have been completed (Stanworth, Purdy, Price and Zafiris 1998; Boe, Ginalski and Henward 1987: Castorgiovanni, Justis and Scott 1993).

A number of studies have tried to determine the "how" of obtaining the franchisee co-operation, or the factors that influence this co-operation. Various possibilities of obtaining co-operation have been tested, for example, the use of power, convincing franchisees of the benefit of the relationship and the use of other non-coercive sources of power (Sibley and Michie 1982; Hunt and Nevine 1974; Strutton, Pelton and Lumpkin 1995).

Conflict in the franchisee-franchisor relationship has also been studied by various researchers. Conflict is influenced by the type of leadership style that a franchisor uses, the degree of freedom that a franchisee perceives themselves to have and the financial dependence of a franchisee to name but a few (Schul, Little and Pride 1985; Knight 1986; Mendelsohn 1992; Strutton, Pelton and Lumpkin 1995; Spinelli and Birley 1996; Gaski 1984)

Hunt and Nevine 1974; Hing 1996; Knight 1986; Lewis and Lambert 1991; Gassenheimer, Baucus and Baucus 1996; Spinelli and Birley 1996 have studied franchisee satisfaction and the factors that influence franchisee satisfaction. Schul, Little and Pride (1985) have found that the franchisee's perception of the quality of the interaction with the franchisor, the quality of the operational support, the reward structure, autonomy and the fairness of the relationship all influence franchisee satisfaction.

Research on franchisee motivation and specifically the aspects that attract individuals to becoming franchisees, were researched by Stanworth and Kaufmann (1995; 1996) as well as Knight (1986). Peterson and Dant (1990) obtained results in their research on this topic supporting the fact that previous self-employment, the number of years operating a franchise business and the level of sales achieved in the franchise business would influence perceptions of the franchise and therefore franchisee motivation. Higher or more positive evaluations on each of these aspects would lead to an increasing perception of power, therefore reducing perceptions of dependence. This in turn will lead to the need for different management strategies by franchisors to keep franchisees motivated. "*...as the level of the franchise relationship and the sales levels of franchisees increase, different advantages may need to be stressed to keep franchisee motivations high*" (Peterson and Dant 1990:59).

2.9.1 Suggestions made in the research literature for future research

Elango and Fried (1997:76) make numerous suggestions for future research in the franchising field. The first suggestion is to pay more attention to implementation issues such as training, cooperative advertising and communication. They also state that franchisee's should be viewed as intelligent players in the industry and should be consulted more often and that the stability of the franchisee-franchisor relationship should be explored.

All of these suggestions where considered when this research project was undertaken and the result of these suggestions can be seen in the choice of research topic, the questionnaire design and the sampling procedure.

2.10 SUMMARY

This chapter provided an overview of franchising. The importance, growth and future of franchising in South Africa and the rest of the world was discussed as well as other aspects such as the definitions of franchising, the parties involved in franchising, the types of franchisees, the types of franchising, the benefits and drawbacks of franchising. A short literature review of franchising research and some suggestions made by other authors were also given in this chapter.

The next chapter will focus on life cycles and will attempt to provide the reader with sufficient information to understand the concept in question.