Topic 2:

Executive Summary *

*(The Executive Summary has been adapted from the original research report conducted by Dedosa Research)

The pros and cons of franchising for chain stores and franchisees

The research presents an independent survey on the pros and cons of franchising for Chain Stores and Franchisees to determine what has worked, what has not and what are the international and local lessons and trends.

Franchising is thought to have originated in the mid-1800s. As a business format, it has attracted attention because of its lower risk of market entry and failure rate. Modern-day franchising has been with us since the mid-1950s when it made its presence in the USA. Today, many businesses adopt franchising as a growth strategy because of its basic characteristics such as the high motivation of franchisees, resource constraint and so on. Therefore, franchising has become a world trend, not only in well developed in industrialised countries like the United States of America (USA) and the United Kingdom (UK) but also in the developing countries. In South Africa, with the progress of internationalisation and its strong purchasing power, many foreign franchisors and local franchisors have discerned this opportunity and entered this market. Hence, one can see many franchised outlets in the South African retail market such as Shoprite and McDonald's. However, there are many pros and cons to franchising.

The main objective of the study is to determine the pros and cons of franchising for Chain stores and franchises. The ultimate aim of the research is to determine what works and does not work as well as the international and local lessons and trends.

A mixed method approach was utilised for this study. It involved desk review, case study analysis and individual interviews. The desk review justifies the research and provides context for conducting a research study. It is a summary and synopsis of a particular area of research, allowing anybody reading the study to establish why a particular research study is being pursued. In addition, this study involved analysing one case study. Single cases can be a valuable and suitable research strategy for theory testing (Yin, 2003) and they can extract rich and in-depth data regarding a particular phenomenon (Siggelkow, 2007). Purposive sampling was used to purposely choose stakeholders in Chain Stores and Franchisees to contribute to the findings of the study, as their knowledge of the franchise model was extensive as they were invested in the model. Personal (one on one) interviews were conducted with a sample of 32 participants (including Franchisees, Executive Managers of Chain Store Franchise, Franchisee Representatives, Franchise Industry Leaders and Stakeholders). A total of 10 questions were administered to all respondents from the 3 provinces in South Africa, namely, KwaZulu-Natal, Western Cape and Gauteng . The findings of the research were generalised to all Chain Store franchises in South Africa. The accessible population of the research study was the individuals who were accessible and actually included in the study.

Data were analysed using thematic analysis to extract the themes embedded in the answers provided by the participants. Data was analysed using Braun and Clarke's six steps of thematic analysis (Braun and Clarke, 2006). This process involved the generation of codes to the information evident in the transcript of the interview. After the initial codes were generated, similar and repetitive codes were eliminated and consolidated (Braun and Clarke, 2006). The final codes were then consolidated and developed into the final themes and sub-themes evident in the findings from the interview (Braun and Clarke, 2006). Applicable quotes were then allocated to each theme and sub-theme of the findings (Braun and Clarke, 2006).

A limitation to the study, due to research related delays and the revised time frame available to conduct the study was that only thirty-two participants were recruited for the interviews. The sample size was owing to accessibility constraints, as all stakeholders could not be accessed within the time constraints of the study. Due to the qualitative nature of the interviews, the findings may not be generalizable.

In terms of a working definition, the International Franchise Association (1960) “A franchise operation is a contractual relationship between the franchisor and the franchisee in which the franchisor offers, or is obliged to maintain, a continuing interest in the business of the franchisee in such areas as know-how and training: wherein the franchisees operate under a common trade name, format and procedure owned or controlled by the franchisor, and in which the franchisee has or will make a substantial capital investment in his business from his own resources”.

Similarly, “The Franchise Association of Southern Africa (FASA) (2019) defines franchising as, “a grant by the franchisor to the franchisee, entitling the latter to the use of a complete business package containing all the elements necessary to establish a previously untrained person in the franchised business and enable him or her to run it on an ongoing basis, according to guidelines supplied, efficiently and profitably”.

The desk review highlighted that some franchise systems have grown into large organisations and franchising permeation of countries and business sectors has been extraordinary. Modern franchising emerged from the US. Franchised business has been adapted to and thrived in almost every culture on earth. Even the least developed parts of the world are encountering a form of franchising, as many non- profits are adopting franchise models to distribute health products and services.

In summary, the desk review suggested the following:

Pros for franchising:

- Franchising offers a well-established business market and brand recognition
- Franchising offers easy setup and lower risk for failure
- Ready customer portfolio and established networks
- Easy to find financial support
- Training and support provided
- Economic independence in the form of self-employment

Cons for franchising:

- Lack of autonomy, strict guidelines/rules and lack of innovation/dependency
- High cost (start-up fees/initial costs/royalties/ongoing costs)
- Contract and legal barriers

The case study analysis revealed that the Shoprite Group of companies was established in 1979. In 1990, Shoprite opened in Namibia. In 1991, it acquired the national Checkers chain. The Shoprite Holdings Ltd is one of Africa's largest food retailers, with a market share of 30% in MGR. The company operates 2,689 outlets in 15 countries across Africa and the Indian Ocean Islands. It employs 147 478 people (more than 120,000 in SA and approximately 23,500 are outside the country). Its customers live in various countries and come from all income brackets. Shoprite caters mainly to the middle to lower- end of the consumer market. Shoprite’s focus is on food, but the company also sells household products, furniture and pharmaceuticals and offers a range of financial services.

The case study analysis showed that The Shoprite Group is the largest supermarket retailer in Africa because of its steadfast commitment to providing affordable food to the communities in which it operates. The company employs 147 478 people across 15 countries. The core focus for the company is on food, but it also sells household products, furniture and pharmaceuticals and offers a range of financial services. Its customers live in various countries and come from all income brackets.

Pros for franchising

The findings from the desk review were supported by data and talking to Shoprite executives. Franchisees benefit from competitive advantages. The Shoprite package ensures that the business is sound and profitable. There are price benefits due to the pricing structure on national and regional levels. The franchise has buying, advisory and assistance with a proven track record in the fast-moving consumer goods industry from the franchisor. Ongoing training and support are provided to ensure the business operates successfully.

Being part of the Shoprite franchise allows the franchisee to benefit from reliable business and supply chain strategies, financial management, stock control, which decreases costs. Other benefits include offering computer support and training services, media advertising utilizing television and radio, additional support in the form of regular trade visits by the Divisional Office, merchandising, promotional and display advice and delivery options out of the Shoprite Distribution Centres in the Western Cape, Gauteng and KwaZulu-Natal.

Cons for franchising

Franchisees are expected to adhere to the Shoprite agreement on business operation. Other franchisees performance impacts the overall reputation of the franchise. Franchisees are accountable and need to adhere to in-country legislative and regulatory frameworks. There are limitations to independence. There are strict adherence and conformance to the business format. There is difficulty operating under such constraints.

There were similarities in the findings between the interviews, the desk review and the case study. Interviewees described their motivation for becoming a franchisee was because of the amount of support provided by the franchisee partnership. It provides a level of security and job satisfaction considering the South Africa socio-economic situation.

Flexibility, money and status were some of the most attractive elements of franchising. Franchising ensures that the brand is well established in the market and provides a safety net for franchisees to grow and develop. However, it does require some degree of self-discipline. The partnership between the franchisor and the franchisee may not always be mutually beneficial. There was a call for balance and the partnership to favour franchisees more. The payment of royalties was discussed during the interviews. Franchisees argue that royalties should be paid across a sliding scale model, where more is paid at the beginning and less as the franchisee becomes more independent. This phenomenon is known as the *franchisee lifecycle syndrome*. Franchisees argued that there are varying levels of support provided and the level of support is outlined in the agreement.

The **pros** of owning a franchise were described as follows:

- Structure is provided for launching, operating and growing the business
- Training and support is offered
- Opportunity to earn more and spend less time and effort compared to their own business
- Opportunity to grow under a brand and share benefits

The **cons** of owning a franchise were described as follows:

- Risks to brand reputation by the actions of other franchisees
- The disparity in service quality across franchisees
- Inflexible business model – franchisees are governed by a contract

Franchising works well because

- Joining an established brand with an existing client base
- Blueprint for success is provided
- The brand has its share of the market
- Franchisees expect their business interest to be protected

Franchising doesn't work well

- When the franchisors interfere with the operations of the franchisee

The latest trends in franchising were described as

- Introduction of social media
- Less reliance on traditional advertising
- Multi-brand franchising
- Increased customisation/personalisation
- Fast casual restaurants

Conclusion

This study examined the pros and cons of franchising for Franchisees and Chain Stores. It also determined what has worked, what has not and what are the international and local lessons and trends. The study found out that franchising is a low-risk method of developing a business since it gives a high return for relatively negligible risk. The risk of failure is low due to the established brand and proven idea. Franchising also has established networks with suppliers and ensures that franchisees benefit from the established networks. The support from the franchisor and the sharing of the ideas, knowledge and experience with the franchisees network minimizes the business risk and helps to run the franchise effectively. Banks are also likely to lend money for the franchise because of an established brand name with a high reputation. The franchisor often provides training and the structure of the business is based on the experience of franchisor which make the risk of failure low. This is because franchisees get support from franchisor in site selection, training, store selection, etc.

In terms of the cons of franchising, the study found out that the franchisees have different goals although they follow the same structure which sometimes cause legal issues. Also, franchisees have to pay a percentage of sales as royalties which minimises profits from outlets. If franchisees depend upon franchisors for advertisement to attract customers and at the end this is not done then there will be no promotion which means a decrease in the number of customers. Furthermore, it is very hard to be innovate with the franchising business. If there is new idea and products the franchisor and franchisee must negotiate and agree on that or any new things that any of the parties want to introduce. It is very tough to implement the new ideas without the consent of each other.

One of the key elements that has worked for franchising is that the franchisee does not have to incur all the risks often associated with starting a business from scratch. Entrepreneurs typically have problems with starting new ventures in the areas of product acceptance; management expertise; meeting capital requirements; knowledge of the market and operating and structural controls. Franchising minimizes the risk associated with these factors through the franchise relationship. The study concludes that despite the loss of control in a franchise; the reduction of risk while still retaining elements of entrepreneurship, has been a powerful motivating factor and the growth of franchising appears likely to continue unabated in the new millennium.

Although most people agree that franchising is a relatively low-cost means of creating new ventures which has grown rapidly internationally, it can also be agreed that the franchise systems has not always worked as anticipated. The franchisees join the life cycle of the franchise system, keen to get started. Some stay keen and succeed, others do not achieve such levels of success and most often demand a disproportionate share of the system (franchisor) resources. The major elements that have not worked for the franchise system include increasing competition, the ever changing product and market, disagreements, economic downturns, regulation and legal issues and market forces.

Finally, the study established that the vibrancy of franchising can be seen through the growing trends both locally and globally.

References

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