

## FRANCHISING SYSTEM AND ENTREPRENEURSHIP

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### 1. INTRODUCTION

Franchising has been and continues to be a very popular way to do business for a number of entrepreneurs. Business format franchising is the granting of a license by the franchisor to the franchisee, which entitles the franchisee to trade under the trade mark/trade name of the franchisor and to make use of an entire package (advertising, training programmes in sales, management discounted bulk), comprising all the elements necessary to establish a previously untrained person in the business and to run it with continual assistance on a predetermined basis (Zimmerer, Scarborough 1988:77). In this study, we examine the relationship between franchising and entrepreneurship, their definitions and franchising system for entrepreneurs. Entrepreneurs enter into cooperative arrangements such as franchise systems. We begin with explanations of franchising and entrepreneurs relationship, then present six deep interview with franchisees in Ankara. This study shows that franchising is not for all entrepreneurs. Some entrepreneurs have found that the characteristics of franchising rules required as the royalty rate, the franchise fee are very strict for them. This study also confirms that all the entrepreneurs should investigate their rights and terms before they invest in the franchise.

### 1. LITERATURE REVIEW

Franchising has grown rapidly as an important source of entrepreneurial activity in Turkey, in sector such as fast food, fashion, business, beauty product and many others during the past ten years (Table 1).

**Table 1 Franchising in Turkey**

	2002 (Actual)	2003 (Estimated)	2004 (Estimated)	Projected Average Annual Growth Rate for Following 2 Years
Foreign Franchises	450	600	750	25%
Local Franchises	450	700	1000	30%
Total Market	900	1300	1750	55%
Turkish Franchises Abroad	50	100	150	30%

**Sources:** National Franchising Association (UFRAD).

Franchising is a specific form of licencing through which to market goods and services. The word “franchising” is presently used to describe business format franchising: the business format franchise is the grant of a license by one firm (the franchisor) to another (the franchisee) which entitles the franchisee to trade under the trademark of the franchisor and to make use of business practices comprising all the elements necessary to establish a previously untrained person in the business developed by the franchisor and to run it with continuing assistance on a predetermined basis (Baroncelli, Manaresi, 1997:225). Common examples include McDonalds, Pizza Hut and Burger King. In these cases, the franchisee operates the unit under a common trade name. The business operation, establishment’s appearance, merchandise and even operating procedures, are standardized to a high degree (Hodgetts, 1982:83). Franchising mainly focuses on the nature of the contractual agreement and on the franchisor and franchisee relationship. Turkey’s population of more than 66 million and its young and ambitious entrepreneurs, makes it an attractive market for franchisors around the world. The Turkish Franchising Association (UFRAD) was founded in 1991 and the first brand was launched in 1987, when McDonald’s entered the Turkey as the first foreign franchise in the country. Franchising is still a

relatively new concept for Turkish entrepreneurs, many franchisors use descriptions other than traditional franchising (i.e., representatives, distributors, agents). The franchisee pays a royalty rate to his/her franchisor in business format franchising, whereas in distributors or agents, the franchisor obtains the majority of his revenues from the sale of inputs to its franchisees at a markup (Lafontaine, Shaw, 1998:98). The International Franchise Association (IFA) has been promoting franchising as a more successful business practice than independent business ownership since 1960s, despite its claims being refuted by United States government bodies and academic scholars (Frazer, Winzar, 2005:1535). Entrepreneurs who want to develop new service or retail businesses often think of franchising as a potential method of expansion. The benefits of franchising include easier access to capital (fee and royalty arrangements), to local market information held by local entrepreneurs (who become franchisees) and to more highly motivated and effective than a salaried manager, reduces the need for franchisor managerial resources (Lafontaine, 1998: 17), product distribution without the typical capital costs associated with internal expansion. Franchisors network can grow quickly, they can tap into local market knowledge which they may otherwise have been unable to obtain, benefit from volume discounts that an independent trader would be unable to obtain (Kinch, Hayes 1986:34; Diamond, Pintel 1980:285). From the perspectives of the franchisee franchising offers brand name recognition, a method of owning a business due to the initial and ongoing training (site selection, advertising, marketing support) and support services, buying power and product research offered by the franchisor. Customers throughout the network can receive the same high quality service.

In the newly developed definitions, entrepreneurship not only includes creating new stuff but also the person who is in charge of controlling an organization is also called as entrepreneur (Kaufman ve Dant, 1998:6). Anyone who starts a business, assumes the risks, and takes the profits of the business can call themselves an entrepreneur. Besides these, can franchising be considered as entrepreneurship? In order to decide this, it is necessary to identify the main properties of entrepreneurship. An entrepreneur is the person who combines production factors to find the necessary financial sources and target markets for economical property and service production. He is the creative attack person who continuously follows markets to catch demand gaps, who creates new demands and does not avoid competition. An entrepreneur not only uses his own experience but also other people's experience to learn new things (Müftüoğlu, 1994: 65-67). The franchise entrepreneur, as the creator, builder and guardian of a unique business format, is responsible for efficiently managing a complex system of independent business owners (Kaufman, Eroglu 1998:69). Franchising is a method that makes small investors and entrepreneurs to be able to get involved in many different areas, and to use their capitals as they wish (Özgentürk, 1993: 5).

Franchise agreements allow both franchisor and franchisee to share the risk of future success of the franchised units. Franchisees are assumed to undertake risky investments because their personal wealth and human capital are tied into a franchised store. However, the franchisee reduces his or her operational risk by making use of the franchisor's well-established business concept (Roh, 2002:49). Franchisors realize that their entrepreneurial project faces many risks if they try to develop their business on their own. If we evaluate the entrepreneurship properties from the point of view of the franchisor, the franchisor is the one who supplies the financial source, manforce market and material riches (Kaufman ve Dant, 1998:13). The franchisor, instead of employing a director, is himself in charge of the job in the field that he believes he is going to be successful at. The franchisee apply the job that was developed by the franchisor in their own study of interests, and try to protect the same quality and service in their environment. When franchisee decide to make something new, they need to share this idea with the franchisor and take the approval of the franchisor. If the franchisor approves the idea, they can make changes in the product and promotion. The franchisees are legally independent entrepreneurs although they obey the franchisors related policies in order not to lower the quality and standard. This limits the control area of the franchisors. Franchisees are not forced to follow the franchisors' policies; especially in fields like pricing, promotions and introducing new products (Lafontaine, 1998:18; Nickels, McHugh, 1990:146). Legally, the franchisee is a firm dealing with another firm, franchisor. This legal classification is apparently a result of the fact that the franchisee must pay for the franchise. The economics of the situation are such that the franchisee is in fact closer to being an employee of the franchisor than to being an independent entrepreneur. Most franchisees saw themselves as independent business owners, satisfied with their earnings and positions as franchisees. However, franchisees' independence is considerably less than that of the conventional independent small business owner. In contrast to the independent entrepreneur, franchisees have to contend with the restrictions of franchisor controls, contractual specifications, and financial costs associated with the franchise system. Franchisees must manage their businesses according to the franchise stipulations regarding product, price, quality standards, and so on, and agree to pay out a portion of their profits in the form of base fees and royalties (Baucus, Baucus, and Human 1993:91-92). For instance, decisions on product content and mix, service presentation, and pricing were largely the franchisors responsibility even if in other areas such as operating hours, staffing and staff wages, the franchisee had considerable autonomy (Stanworth, Curan, 1999:337). Franchisees act as entrepreneurs owning for profit business ventures, innovating to create new local organizations, and seeking growth in financial performance and via additional franchise units (Baucus, Baucus

and Human 1996:361). The franchisees work with enthusiasm and determination in their works, observes to determine their customers' needs and desires, communicate and maintain their own financial sources. They can face a situation of taking decisions under indefiniteness. The franchisees need to find out entrepreneurship and creativeness sources. In addition, it should not be forgotten that they are expected to be more motivated than directors are. They do not only bring along directing abilities and work experiences but also provide motivated human source. If we evaluate entrepreneurship, it is the franchisor who is going to develop the brand, product and the system. It has a reliable brand name, image and potential customers. It makes feasibility work and marketing researches before getting into target market.

The literature provides a somewhat contradictory set of definitions of entrepreneurship. For instance, Amit, Glosten and Muller (1993) note that entrepreneurs are often "categorized into those who are not profit-seeking, either working individually or in a corporate setting, and those who are not profit seeking, working in charitable, government and other not-for-profit organizations". New definitions have been offered for entrepreneurs that don't include the creation of a new and innovative enterprise. For example, Shabe and Cable (1997) define entrepreneurs as "individuals who receive their compensation in the form of residual claimancy on the proceeds of a firm and who also have operating control of an organization" (Kaufman, Dant, 1998:7). Kaufmann and Dant have been categorized the definitions of entrepreneurship and their applicability to the franchising concept (Table 2). Norton noted that franchising is an institution to "circumvent the entrepreneurial capacity constraint". Norton emphasized that the growth and the size of firms are constrained by monitoring problems. Focusing on the monitoring function of the entrepreneurship, Norton cited "entrepreneur is a monitor whose principal task is to assure that all hired factors of the firm provide their promised level of service to minimize "shirking". An entrepreneur has to spend more time in monitoring as the firm grows (Garg, Rasheed, 2003:332).

**Table 2 Definitions of Entrepreneurship and Their Applicability to the Franchising Context**

<b>Representative Definitions of Entrepreneurship</b>	<b>Application to Franchisors</b>	<b>Application to Franchisees</b>
Entrepreneurship is an individual who possesses qualities of risk-taking, leadership, motivation, and the ability to resolve crises (Liebenstein 1968)	Yes	Yes
Entrepreneurs are leaders and major contributors to the process of creative destruction (Schumpeter 1942)	Yes	No
Entrepreneur is an individual who undertakes uncertain investments and possesses an unusually low level of uncertainty aversion (Knight 1921)	Yes	Yes
Entrepreneurship is the creation of new enterprise (Low and Mac Millan 1988)	Yes (concept)	Yes (market)
Entrepreneurship is the creation of new organizations (Gartner 1985)	Yes (concept)	Yes (market)
Entrepreneurs introduce new combinations of the factors of production (land and labor) that, when combined with credit, breaks into the static equilibrium of the circular flow of economic life and raises it to a new level (Schumpeter 1934)	Yes	No
Entrepreneurship is the process of extracting profits from new, unique and valuable combinations of resources in an uncertain and ambiguous environment (Amit, Glosten, Muller 1993)	Yes	Yes (ambiguous environment)
Entrepreneur performs one or more of the following activities: (1) connects different markets, (2) meets/overcomes market deficiencies, (3) creates and manages time-binding implicit or explicit contractual arrangements and input-transforming organizational structures, and (4) supplies inputs/resources lacking in the market-place (Leibenstein 1968)	Yes	Yes
Entrepreneurship is the purposeful activity to initiate, maintain and develop a profit oriented business (Cole 1968)	Yes	Yes
Entrepreneurs perceive profit opportunities and initiate actions to fill currently unsatisfied needs or to do more efficiently what is already being done (Kirzner 1985)	Yes	Yes
Entrepreneurs are residual claimants with operational control of the organization (Shane and Cable 1997)	Yes (System profits/ shared control)	Yes (Unit profits/shared control)

**Resource:** Kaufman Patrick J., Rajiv P. Dant (1998), "Franchising and The Domain of Entrepreneurship Research", Journal of Business Venturing, vol 14, p.9.

## QUALITATIVE RESEARCH

### METHODOLOGY

This study began with a literature review and then a interview guide was developed in interviews. The primary goal of this study was to obtain information about franchisees feelings, beliefs, attitudes on franchising system. In this research, the franchising system is evaluated from the point of view of entrepreneurship. The selected study population was a food service franchise systems and their franchisee owner-managers in Ankara. They were business format franchising and show significant growth potential. Confidential face to face interviews were held with 6 franchisees chosen as a convenience sample from retailed food industries in Ankara. The face-to-face interviews were conducted with the person who is directly (personally) in charge of the franchising business which has been in business for at least 1 year. The reason for why only 6 firms were interviewed was to get richer information. Because the purpose of a qualitative study is not to achieve generalizability, in this study a type of purposeful sampling is used. 6 franchisees who were thought to be knowledgeable about the research topic were interviewed to collect information on the franchising-entrepreneurship relationship and their franchising experiences. A convergent interviewing approach was used for the indepth interviews that lasted approximately 45 minutes. The interviews were taped with respondents permission and later transcribed and analyzed manually by the researcher. The interview topics include their own story about franchising, the reasons of franchise taking, the difficulties involved, deciding way, whether the franchisees feel as entrepreneurs or not, and the relation between the sides. Respondent franchisees were asked to discuss a number of issues relating to entrepreneurship, including examples of the reasons of franchise taking, who had left their systems, reasons for the entry into the system, franchise or own business?, which they prefer?, franchisee selection procedures, failure reasons (Appendix A, Appendix B). We begin by asking a general question such as, "Why did you join the franchising system, how do you feel in the franchising system?" then encourage the subject to talk freely about their attitudes toward franchising and entrepreneurship. Probing is done by asking such questions as "Why do you say that? That's interesting, can you tell me more? Would you like to add anything else?" With the use of deep interviewing, observation notes, and the previous studies made in this area, it was investigated which entrepreneurship properties that the franchisees have, whether they see themselves as entrepreneurs or not. In this study the idea is to examine the meaningful and symbolic content of qualitative data. By analysing interview data we ask the some following questions about the data we are coding:

Franchisees interpretation of the franchising system and entrepreneurship,

How you identify or classify yourselves and franchisors in this system, entrepreneur or not

The coding process enables collect together all the datas, ideas and then different cases can be compared and analysed. The obtained data were divided into smaller categories and the opinions of the franchisees were reflected completely. Each firm which was interviewed was numbered from 1 to 6. All the 6 interviews (all the responses) were analyzed with all the sub-categories and compared with each other to see if they form a meaningful pattern. Notes and interviews are transcribed. The obtained data was then tabulated. For the validation of the research, previously made works were observed and the opinions of other researches that had worked in this area were taken into account. For reliability the franchise takers word were quoted exactly and presented to the reader without making any comments. In the franchising system, the franchisees gains the brand name, operating system and becomes a part of a strong organization.

### CONCLUSIONS

In the system, since actions are being done with the main company (franchisor), risks and operating responsibilities get lower. The franchisee minimizes the risk of operations by utilizing franchisors national identity, national advertising and training programs and materials. However, we need to say that before deciding to take franchise, an entrepreneur should think well and decide to leave some of his independence. Financial resources provided by franchisees. In this system, the regulations and rules of the franchisor should be accepted and payments should be done regularly. The entrepreneur who wants to take franchise can keep working successfully with the brand whose success had been proven and support of the main company. On the other side, although it is an independent company, he (or she) should take into account that he (or she) is not going to be able to make all changes the way he (or she) wants to. In the results of our interviews about franchising, it was found out that the franchisors give most importance to the economical situation of the potential franchisee candidates and the terms and regulations of the franchisors are completely accepted, and some franchisees consider themselves as entrepreneurs. This study indicates that the franchisor has the decision power in

franchising system. The franchisees should be certain about that the franchisor will be able to provide the necessary help when the system begins to work and have all the information about the franchisor. In America, the franchisor has to inform the franchisee fully, however in Turkey such a definite term is not present. In Turkey there are franchisees who are not aware of region protection, which is in the functioning region of the franchisee there shouldn't be any other franchisees. In order to protect system success, the franchisor gives importance to detections. The franchisor can do detections as a secret customer. In stead of sudden detections, if general detections are made, the franchisees will see themselves as a part of the system and won't feel nervous about it. Forty or fifty pages of contracts make the entrepreneurs feel confused. The responsibilities of the franchisors should be declared to the franchisees as a summary before the agreement. The misuse of the franchisees' ideas and presenting those ideas as if developed by the franchisor and put into the contract with the efforts of the franchisor, effects the franchisees' creativeness in a negative way. The franchisees should also benefit from the price reductions that the main company makes on cumulative buying. It should not be forgotten that the franchising system is a method, which will make both sides happy as long as it is applied in a cooperative and honest way. Most franchisees seemed pleased with the system. Franchisees can make contribution to franchise system in way to pionerring ways of adapting to local conditions such as cultural differences. This study shows that franchisees should investigate the franchise system they want to invest in, going beyond the information about royalty rates, advertising rates.

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Appendix A SME-Entrepreneurship Global Conference 2006 - Refereed Paper			
FRANCHISEE CATEGORY	FRANCHISEE 1	FRANCHISEE 2	FRANCHISEE 3
Year Established:	2002	2004	Aralık 1996
Employee:	20-30	8	10-12
Business field:	Food	Food	Food
Royalty rate:	% 13(royalty (%8), reklam(%5)	-	% 6
Franchise Fee:	40 000 \$	20 000 \$	20 000 \$
Experience	Yes	Yes	No
Contract length (years):	10-15 year	-	-
The reasons of franchise taking	Brand awareness (known trade name), recognition. Potential customer, high profitability	Profitability Providing support Recognition, established name Brand name	Brand name, Quality Marketing power
The difficulties involved	Franchisors rules Limited independence	High start up costs Control Complex procedure	Standardization
Deciding way: What kind of decision made by the franchisee in the system? Any change?	No	Price, promotion.	Promotion.
Do you employ a manager in the franchise business ?	Yes	Yes	Yes
Do you feel as an independent entrepreneur yourself in this business?	No	No	No
Do you know any franchisee leave this system?	Yes	Yes	Yes
Reasons of failure	Conflict with franchisor Control Lack of legal recourse, long agreement	Bad location Poor marketing Poor demand for product Poor region protection, Competition in the same area	Bad location Adequate training, support Loss of goodwill, Loss of brand name
Franchise or your own business? Which do you prefer?	Franchise	Own business	Franchise
Franchisee selection procedures	Economical situation Finance	Economical situation, finance personality	Economical situation Finance
Appendix B			
FRANCHISEE CATEGORY	FRANCHISEE 4	FRANCHISEE 5	FRANCHISEE 6
Year Established:	1986	2001	2001

