

Franchising as a Form of Business Organization

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Abstract: About 150 years ago franchising as a special mechanism was introduced to the financial relationships of individual firms. Initially created to sale Singer sewing machines, franchising brought new opportunities of economical relations between organizations. Thus, large businesses were able to increase the sales of their products, to promote the brand and raise the profits. And for small businesses the emergence of franchising provided new opportunities for creation of a reliable business under a recognizable brand.

Key words: Franchising • Financial mechanism • Commercial concession • Franchisee • Franchiser

RESULTS AND DISCUSSION

In the European countries 85% of recently organized firms “live” until 5 years, but as for the franchising firms only 14% crash. In the USA the statistics is more impressive, 90% of new firms “die” haven’t lived until 5 years and only 5% of franchising firms [1].

You can find a great number of books devoted to the franchising. For example, Ian Murray “Franchising. The kinds of franchise, where to get finances, how to succeed”, Steven Spinelli “The way to the wealth.” etc. As you can see from the titles of the books, the franchising is connected with success and even wealth.

The essence of such (though not new) financial mechanism implies the possibility of making a special treaty which in Russian legislation is defined as ‘commercial concession’. Article No.1027 of the Civil Code of the Russian Federation gives the following definition of this term: “One party (a right holder) for a fee shall provide another party (a user) with the right to use a set of exclusive rights obtained by a right holder which includes a right for a trademark, servicemark and other rights specified in the agreement, such as a right for commercial designation or know-how” [2].

The system of franchising is based on the interaction of two subjects: franchisee and franchiser. The first of them is an individual or a juridical person who wishes to acquire a right to use the franchiser’s trademark and the system of service and production in his entrepreneurial activity. As a rule, franchisor is a large organization with a well-known brand name and its own image, ready to grant such rights to a franchisee for a fee. The Franchiser- is an owner of the exclusive rights to any ideas, firm style and brand. The business of franchiser always has a certain, checked market of consumers and the valuable reputation. An agreement between two parties is called a franchise.

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A product or service is an integral element of franchising. Such product or service should obtain the following features:

- Well-known brand;
- Limited range of products.

Thus, the objects of franchising include:

- Commodity that has a material form;
- Service;
- Manufacturing process;
- Business process (a set of managerial, commercial, financial, organizational actions);
- Complex product that combines a variety of goods [3].

Such form of business is widely used in foreign countries. It is spread in various economic sectors. After Singer's success in applying franchising to his business, franchise system of use and sales began to develop rapidly. Hence, in 1898, an automobile company General Motors tested this mechanism. And now we may say that then franchising in particular gave the company a new incentive for development. Leadership of General Motors decided that it would be much more effective to hand over the control for the marketing of products to those dealers who engaged themselves to sell only General Motors cars. Those dealers also partially contributed to the joint deal, what, in fact, represented the collateral warranty. Such tactics resulted in strengthening of the firm's position in the automotive market.

Later, the system of franchising was picked up by such well-known companies as "Coca-cola" and "Pepsi", what allowed them to extend their market. After that every year the level of franchise sales was increasing in several times. In 1926 the Independent Grocers Alliance (IGA) was founded in Chicago. Besides, the European network of grocers developed in European countries. This proved that franchising had finally taken roots in the role of popular financial mechanism among a variety of major companies around the world. Gradually this system reached the Russian borders. Today, it is hard to define who was the first to use franchising in native practice. However, we can assert that the Russian system of franchising differs significantly from the foreign one. First of all, a very private way of running business makes this difference, since in Europe transparency prevails.

Due to the franchise, the franchiser has the following advantages:

- The emergence of additional money for the further development of business. If the firm plans to go to the regional, national or international level, they will need additional investments for the development. When the franchisee and franchiser make the conclusion of a contract, the franchisee can buy additional services from the franchiser, for example, concerning management (the special support in consulting and marketing). Also, the franchisee monthly pays money to support the services, which are provided by the franchiser. Part of this money will be spend for giving the services to support the franchisee (staff training course, providing with consultants etc.). The purchase of franchise by franchisee and purchase of special services are the additional sources of benefits for franchiser.
- Franchising gives an opportunity to broaden its influence at the new markets and also to strengthen its reputation. The mastering of new markets goes due to the franchisee, which bring there the name of franchise, they develop quickly and make the investments for the developing of this brand in new cities. So the popularity of this franchise rises, although the franchiser himself practically has not done any efforts.
- Due to the franchising the customers can learn more about the products, goods and services of this firm. The new stores with the name of this franchise are opened and people begin to try its products, the brand becomes to be well-known. The franchisee advertises the products of franchise and as a result the volume of selling increases and the product's competitiveness becomes stronger.

The franchiser provides the buyers, who bought the right to use its idea, with various forms of support (marketing, advertisements, information, supply of raw materials, training of specialists, sale of goods etc.)

The franchiser's list of benefits consists of:

- Franchising gives an opportunity to get an own business, although the franchisee doesn't solve the problem by himself and gets the franchiser's professional support. The beginners can avoid a lot of mistakes with the help of this support. If the franchisee wants to take a wrong decision, more experienced franchiser will warn him, because the result of this decision can worsen the firm's condition or even destroy it.
- Franchising-is a quick and effective start. Franchisee gets the information from the franchising system, which helps to choose the best place for opening, the beneficial design, points the right decision for running business. The franchisee doesn't come across the problems, which the beginners usually have, because he has got his franchiser's experience and protection.
- Franchising provides the support to franchisee during the period before the opening business. The franchisee shouldn't spend time for learning and acquaintance the business in this particular sphere. The franchiser can give him all necessities, including special training and managing programmers.
- Franchising-is a constant support. The franchiser is interested in the success of the franchisee that means that, all difficulties are solved together. At any moment the franchisee can ask the franchiser for help. Due to this support, the probability of the wrong decisions decreases, so the survival and success increases.
- The opportunity to use the franchiser's image and trademark is another undoubted advantage. For example, if you are the franchisee of McDonald, you have a right to use the name of the firm and it gives an immediate recognition as a firm that runs its enterprise in the city, you will have a great number of customers which have already known your goods. You have no need to create the image, everyone have already known your trademark. But as for the new, unknown entrepreneur, he will do his best to make the consumer demand and the reputation. Franchisee buys the reputation with the purchase of franchise. The entrepreneur will never have the access to the world-known name, but the franchisee can use the world-respected name of his franchiser at once.

Today there are about 800 000 franchises, which run their business in the spheres of clothes, shoes, tourism, catering, beauty salons etc.

Let's consider the most successful and well-known franchises.

Automobile Franchises: The most profitable and rapidly developing sphere of automobile industry. It is impossible to start this kind business from the scratch. That very fact pushes the companies to the franchising to have a possibility to deliver the cars to the consumers.

Restaurants Franchising: Nowadays the most popular franchise in this sphere is " McDonald". It was founded by the brothers Dick and Mack McDonalds. By the 1955 "McDonald" had become the franchise, because Ray Crock appeared and became an exclusive agent concerning the franchising. That was he who made the company of chain restaurants "Fast food". Restaurants "McDonald's " are opened in 33 countries of the world.

Clothes Franchising: The most standing out franchise is "Zara". It was founded by Amancio Ortega in 1975. The main activity was the production and sale fashionable outfits for the acceptable prices. "Zara got its popularity because it took her only 2 weeks to create the new collection and deliver it to the shops.

But the average time of another company was at least 6 weeks. "Zara" invests in the new stores, it doesn't invest in the advertisement. That's why today there are 1500 stores of this firm. TV channel "CNN" called "Zara" "Spanish history of success" [4].

The world practice proves that franchising – is one of the most effective ways of developing business not only for large companies but also for beginner. Thanks to the franchise it is possible to start the business practically from the scratch and have more chances for a certain success.

Many entrepreneurs often consider franchising to be an ideal solution for establishment some new business. In the eyes of young businessmen franchising scheme seems to be virtually risk-free. In fact, entrepreneurs who embarked on the way of franchising, realize in the end that this is not only a great way of establishing your own business, but also a system enclosing a set of pitfalls.

Many aspects restrain the development of franchising in Russia. First of all, we refer to them franchisees who want to run their own business. Most of such entrepreneurs are:

- Young people who are ready to take risks. Such entrepreneurs obtain some accumulated capital, which, as a rule, is small.
- People who for many years of employment experience have earned enough money to open their own business.
- Small businesses looking for protection and support of a large firm, which is why transferring their business under the trademark of a larger company.

Often the hope for advertised and at first sight simple franchising is destroyed by the harsh reality. Not only a franchisee may face some risks, but also a franchisor. The imperfection of Russian legislation and lack of practice of resolution of conflicts between the parties, who concluded a franchise agreement, are to blame.

In particular, franchisor may face the following problems:

- Loss of the established reputation. The unscrupulous franchisees who do not comply with initial technologies, standards and regulations of production in a desire to renovate and "improve" the product.
- The emergence of extra competition in the face of the franchisee, if separation of both parties is within the same city or district, i.e. located close enough to each other.
- An important place is occupied by the risk of disclosure of confidential information. Franchisee often can not provide the necessary control over the trade secrets. On the other hand, the franchisee may deliberately disclose such information to potential competitors, due to lack of experience in running business.

However, franchisee's newly established business might be not as successful as he expected. First of all, many franchises do not bring the desired revenue. Often it is not even connected with the inexperience of a franchisee, but with the fact, that franchisor may misinform franchisee about the prospects of development, the state of the market, place of franchisor in it, etc.

Also, there are great risks when working with a foreign company. After all, the organization that is successful abroad may appear absolutely irrelevant and not competitive in the country of franchisee.

Moreover, franchisor may not be fair enough to provide franchisee with an adequate support. Russian very common motto "every man for himself" is here to blame. The fact is that franchisor will never take risk if he has an opportunity to send franchisee to unexplored expanses of a new market [5].

Of course, all the facts mentioned above do not mean that the franchise market in Russia is doomed to failure. On the contrary, it is actively developing and growing. Besides, franchisee risks are still less than the risks of an average entrepreneur. Thus, "about 6,000 franchisee entrepreneurs operate in Russia under license of more than a hundred franchisors." In addition to this, "according to some estimates, the potential capacity may reach up to 60 000 franchised outlets in various fields of business" [6]. The set of regions in Russia have been developing franchising within their territories for several years. Regional center of the Volgograd region is not an exception.

Franchise system is actively used and developed in Volgograd. Herewith, the most popular sector for franchising is fashion clothing retail. Every year new brands appear and boutiques of world-known companies are opened in the city. Over last 5 years, the number of shopping centres in Volgograd has increased what played an important role in franchise system. Novice entrepreneurs purchase a franchise as an easier way to stay in the market, as it provides advertising and mechanisms for sales promotion. Thus, an entrepreneur receives big support before a start-up and during the actual running of his business.

Fast-food sector is in the second place in franchise sales in Volgograd. Such foreign brands as “McDonald's”, “Subway” and “KFC” are popular there.

Despite much progress in franchising development in Volgograd, many entrepreneurs face a number of problems.

The main problem is the imperfection of regulatory and legal framework. The Russian legislation does not have a concept of ‘franchising’, it is replaced by the term ‘commercial concession’. And the problem is not in the substitute of terms, but in the fact that many aspects of running this business form are not legally recorded. The lack of legal norms, for example, to a large extent complicates the process of crediting franchisee, since when crediting, franchisor acts as a franchisee’s guarantor and has to prove to the bank the benefits of a franchise project [7].

According to some experts’ point of view [8], the problem is that Russian and Volgograd, in particular, franchise market in manufacturing sector is underdeveloped. This is true due to the high level of risks connected with the resource-intensiveness of this sector.

However, Volgograd franchise market is extending every year. The demand for franchising predicts new solutions of the problems associated with its development.

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