Factors influencing of franchise model

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Abstract

Trends in the world economy are actively developing in the field of franchise relations. The franchising business model helps companies quickly establish themselves on the market, their rapid development, advancement into the production sphere, and the sphere of providing services of the latest technologies. Currently, franchising is used in most developed countries of the world. Franchising for the economy opens opportunities to expand jobs, and increase GDP, tax revenues, and international cooperation. The rapid development of franchising is restrained by certain factors, such as the imperfection of the legislative framework, the lack of experience of working in the framework of franchising among domestic entrepreneurs, dishonest attitude to the fulfillment of contractual obligations and other people's intellectual property, the low level of development of bank lending, etc. Today, the franchise market is very saturated, so potential franchisees should pay attention to their preferences, economic potential, and the possibility of a quick return on capital investments. For this purpose, we propose to analyze the internal and external factors of choosing a franchise. As external factors considered: market trends and conditions, trust, brand impersonality, knowledge transfer mobility, distinctiveness, adaptability, and knowledge documentation. As internal factors considered: the capabilities of the chosen enterprise, the possibility of quick recovery of capital investments, the number of initial contributions, the efficiency of the management service, and the responsibility of the enterprise.

Key words*: franchising, franchisee, franchise market, entrepreneurship, market trends.*

JEL Classification: *M410, M420, O12.*

Introduction

In the modern realities of conducting and introducing a business, several risks and problems arise that slow down the process of entering the market, therefore, it is popular to define various business models that are productive and provide an opportunity for successful development of business and management. One of these models is franchising, which allows rapid development, stimulates sales of products or services, attraction of new investments and interaction between a network of enterprises. With the help of franchising, the company can reduce competition, by strengthening competitive advantages, increasing profitability, and quickly entering the market.

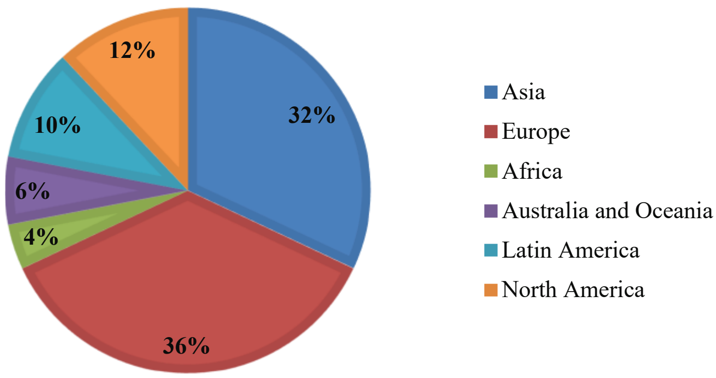
Franchising is a type of relationship that is built on a contractual basis, allowing the franchisee to obtain a ready-made business model for an appropriate fee to the franchisor, also called a flat fee, together with the appropriate brand, established production, concept, distribution channels, trademark, and recognition, where the franchisor controls and helps develop the network of enterprises.

Result

Since franchising is a popular type of business in the world and is spread in almost all countries, this direction is constantly developing, new industries and new enterprises appear. Each year, the number of franchise enterprises is increasing, as evidenced by the regional structure of franchising, which is presented in Figure 1.

The structure of franchising in the world

Figure 1



Source: based on data from the International Franchise Association [1]

The largest share of franchising is in Europe, this is since Europe occupies a large share of the territory and includes economically developed countries in which the sector of franchise enterprises occupies a large share.

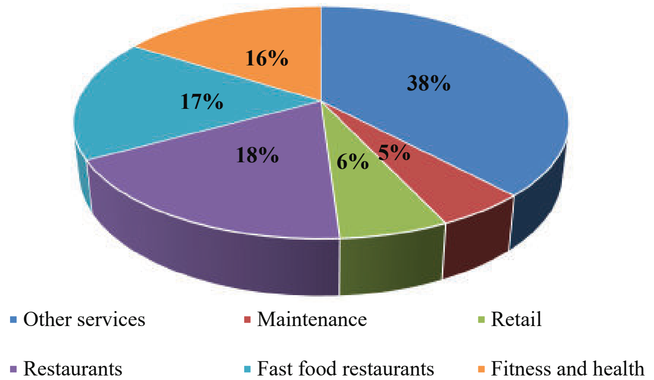
Asia has a slightly smaller percentage - 32%, which is also a large share in the regional structure. The form of doing business according to the franchise model is 12% in North America, and 10% in Latin America.

The smallest share is occupied by Australia and Oceania - 6% and in Africa - 4%. In general, this is related to the economic development of countries and territorial features.

Regarding the branches of franchise enterprises in the world. They have a wide range of directions, the main and most popular industries are grouped together and presented in Figure 2.

The structure of the branches of franchise enterprises

Figure 2



Source: based on data from the International Franchise Association [3].

As can be seen from Figure 2, the largest share in the structure is occupied by other services - 38%, a large share is occupied by restaurants and fast-food restaurants, which are popular and widespread throughout the world - 18% and 17%, respectively. The smallest share is occupied by retail trade and maintenance - 6% and 5%, respectively, they are fewer common industries in relation to franchise enterprises. There is a popular trend of a healthy lifestyle in the world, which is why the network of fitness clubs is gaining momentum, such an industry as fitness and health has a share of 16%.

Business for any state is a major component for the development and activity of the economy, high competition on the market and a significant share of enterprises in Ukraine constitute significant obstacles to the opening of new companies and operational risks for already existing enterprises. Therefore, franchising as a business model is effective both for the development and expansion of large enterprises and for small business startups.

In franchising relations, there are 2 parties - the franchisor and the franchisee, for both parties there are several disadvantages and advantages [6].

Also, franchising can be defined as a ready-made business model, according to which the enterprise receives a complete concept and idea. Such a model has high costs for the franchisee, which in the future he aims to pay off and increase his own profits. Therefore, it is important to analyze an already purchased franchise or choose it among many areas of activity.

If the franchisee aims to open his own business based on the franchise business model, then at the initial stage it is important to collect information about the potential franchisor. The main indicators of information selection are given in Table 1.

The main parts of gathering information about a potential franchisor [4]

Table 1

№	Information	Main indicators
1.	Duration on the market, state of the enterprise and prospects	Duration on the market, level of popularity and prestige on the market, business reputation, financial condition of the enterprise, organizational structure, qualifications of employees, expansion, and development of activities
2.	The financial aspect of the costly part of obtaining a franchise	Costs for creating an enterprise based on a franchise business model, the amount and payment of royalties, lump-sum payments, additional payments, availability, and conditions for obtaining a franchise, the possibility of receiving financial assistance, projected financial results
3.	The organizational part of obtaining a franchise	The types of activities allowed by the franchise, the possibility, and conditions of conducting other types of activities, the franchise package, the advertising component of the company, the procedure for drawing up reports at the enterprise, the conditions for breaking relations and the franchise agreement, the speed of mastering the business model and personnel training
4.	Performance and relationship with the franchisor	Stable income of the franchisee, the dynamics of the development of franchise enterprises, the presence of lawsuits by the franchisor, the presence of conflicts and termination of contracts with other franchisees, honest performance of duties by the franchisor.

When looking for a franchise, you can contact the national franchising association of the respective country where franchising is developing. National franchising associations have been established in most countries where the popularity of running a business based on the franchise model and franchising in general is growing rapidly.

The purpose of these associations is to help franchisees in finding a reliable franchise and franchisor, providing information about the business that the franchisee is interested in, informing about conducting business according to the franchise business model, consulting on franchising issues, representing franchising in state authorities, etc.

The Franchise Association of Ukraine offers its services for finding franchise networks, namely, they arrange conferences, exhibitions, seminars, presentations, publish specialized reference publications, magazines, catalogs, descriptions of the activities of franchise enterprises, engage in mass media and publications in them, place advertising materials, etc. [6].

The franchise market is quite saturated and offers a variety of business models, types of activities and specifics. To choose a truly reliable franchise, it is necessary to analyze the influence of external and internal factors on the franchise model during the selection process. External factors are factors that an individual cannot influence, and therefore he should adjust his activities to these factors and control their occurrence and consequence on the enterprise, from the side of franchising, such factors are presented in Table 2 [2].

External factors that influence the choice of franchise model

Table 2

No	*Criterion*	*Main indicators*	*Characteristic*
1.	Market trends and conditions	Product demand in the future, market expansion, competitiveness, impact of computerization and the Internet on the enterprise, uniqueness.	These indicators are key for the enterprise, the analysis of which will help to choose a business concept oriented to market demand.
2.	Trust	The size of the franchisor's enterprise, divisions, management efficiency, brand awareness of consumers of goods or services, duration of work on the market, publicity of the company, competitive advantages, among others.	to pay attention to its main mission, goals and competitive advantages when choosing a franchisor. The problems of the franchisor will also affect the franchisee, which will not allow the business to develop rapidly.
3.	Depersonalization - laziness of the brand	Evaluation of the role of the person in the value of the brand	There are companies where the identity of a specific person is the value of the brand, if you buy a franchise when the company does not have this person in the staff, then the value of the company will not be the same.

4.	Mobility of knowledge transfer	The ability of the franchisor company to quickly train the personnel and systems of the enterprise	If the franchisor's business is quite complex and has many nuances, the company will not be able to quickly absorb knowledge, which will slow down the company's development and profit.
5.	Difference	Features that can distinguish the company from competitors and provide advantages	This can be a certain special concept, lower capital costs, a unique marketing service strategy, certain bonuses for consumers.
6.	Fitness	To what extent can the business concept be adapted to a certain region or market in which the franchisee aims to operate	The business model should adapt well to geographical features and consumer tastes. It is important to collect information about whether the laws of the state allow this activity to be carried out.
7.	Documentation of knowledge	System of transfer of franchise rights and business management	A successful franchisor must have some documentation of how the business is to be conducted. It can be a code or regulation.

As can be seen from Table 2, when analyzing these criteria, the franchisee will be able to insure himself in choosing a franchise so that this business is successful and profitable.

Equally important when choosing a franchise are the internal factors and capabilities of the enterprise itself, as they indicate exactly the activities and capabilities of the company, its real results.

Such factors are:

1. Company capabilities. This factor is affected by the amount of the franchise and the payment for its use. Such an analysis can be made based on existing businesses that operate under the franchise model, namely the ratio of their profits or revenues to the royalties that must be paid to the franchisor, regardless of whether they are fixed or as a percentage of revenues or profits. Additional payments in the form of advertising deductions also affect this indicator.

To analyze the expediency of paying the specified amount for the use of the franchise, you should compare similar franchises on the market and obtain results about the fairness of the franchisor's royalty amount. It is important to understand not only the ratio of profits to the portion of deductions in the form of royalties, but also the value of a given brand and prestige in the market. There is a certain relationship here, since the higher the value of the brand and its business, the higher the price for using the franchise, so the indicator will have a certain deviation.

The franchisor should be interested in increasing the income of the franchisee, in the same way as the franchisee, therefore it is important to analyze not only the number of deductions, but also the prestige and success of the business model.

To analyze the above indicators, it is necessary to understand how the franchisee needs to pay for the use of the franchise.

These can be a) assessment of the fair value in the case of a one-time lump sum payment; b) assessment of the mixed fee in the form of a one-time lump sum and in the subsequent royalty; c) assessment of the fairness of the level of royalty rates to profit or revenue.

Paying only a lump sum at the beginning shows that the franchisor does not have a certain level of trust in the franchisee or that his business does not bring value and profitability in the market. The level of awareness of franchisors in franchise pricing can also influence this.

In order to evaluate the ratio of the level of profit to the payment of royalties, the franchisee must have a business plan for the development of the same business or type of activity that the franchisee wants to conduct, on the basis of which you can get a relative idea of the costs of the enterprise, the average prices for the purchase of raw materials, the prices of goods, sales prices and the approximate level of profit that the company can get. Thus, it is possible to determine an acceptable cost for using the franchise.

2. Recovery of capital investments. Although the franchise model is a ready-made business with an idea and a brand, it requires significant costs and capital investment at the beginning. That is why the franchisee aims not only to increase profits, but also to return their own capital investments, which will be evidenced by the profitability of the business.

ROI indicator is used to determine this - payback ratio.

$$ROI = \frac{Income - Expenses}{Expenses} \times 100\%, \tag{1.1}$$

where, costs are the volume of all invested investments.

ROI shows the return on investment and is designed to determine the return on investment. The ROI indicator must be at least 20 percent by the second or third year of the enterprise's activity to recognize the investment as truly profitable.

3. Initial capital. To operate a franchise business model, you need to have initial capital and resources, usually when a franchisee decides to operate a business model, he has a certain plan for initial costs.

The main task at this stage is to determine the sources of financing and the directions of its use for stable profit from activities, maintaining the liquidity of the enterprise and timely settlements with creditors and the budget.

Sources of funding can be: a) own financial resources, monetary contributions of the founders; b) loanable funds (bond loans or bank loans); c) free contributions or charitable contributions of institutions, organizations, individual economic entities; d) implementation of activities at the expense of extrabudgetary funds; e) funds of the Development Fund of Ukraine, which are formed at the expense of deductions from business entities; e) foreign investments; g) other sources of financing that are not prohibited by law.

Based on the above, it is possible to allocate financing at the expense of own and borrowed funds. Own funds are formed based on invested cash or resources, which does not entail additional costs in the future. If external financing takes place with the help of borrowed funds, then the company additionally bears costs in the form of interest on the loan and in the subsequent return of the body of the loan. Based on this, there is a risk of mandatory return of funds, even if the company suffers losses or goes bankrupt. This also affects the company's profit, which provokes its decrease in the future.

To analyze and control these indicators, you can use the coefficient of financial autonomy, which shows how much the company's assets are formed at the expense of own capital and how independent the company is from external financing [4].

$$Autonomy\ coefficient = \frac{Equity}{Amount\ of\ liabilities}, \tag{1.2}$$

Therefore, the share of equity capital in the total amount of financial resources of the enterprise should be at least 50 percent, and the coefficient of financial independence should be more than 0.5.

If the company raises funds with the help of loans, then the coefficient of financial leverage should be analyzed for this purpose [7].

$$Financial\ leverage\ ratio = \frac{Long{-}term\ funds\ raised}{Equity}, \tag{1.3}$$

The indicator of financial leverage helps to determine the dependence of the enterprise on long-term obligations.

4. The efficiency of the management service. To carry out activities at the enterprise, a clearly established mechanism is required, according to which each employee clearly knows his duties and the mechanism of their fulfillment, the creation of a structure at the enterprise is entrusted to the managers and managers of the company. To establish a management service at the enterprise, you need to familiarize yourself with the main indicators:

a) the state of the organizational structure, which reflects the ability of the enterprise to use its market opportunities. This structure can be evaluated using the degree of conformity of the ratio of the products sold to the structure of demand and the degree of satisfaction of demand for certain products or services.

b) indicators that reflect the technical and organizational level. Such structures include the level of centralization of management functions, the adopted norms for enterprise management, the balance between the rights and responsibilities of employees.

c) cost efficiency indicators.

5. Responsibility of the enterprise. An important aspect for every enterprise is the timely payment of all expendable parts of the enterprise.

These include a) timely payment of all possible taxes and fees; b) payment of wages; c) repayment of payables; d) repayment of the loan and interest on it (if available).

Also, the enterprise is responsible for its employees, namely for providing workplaces and their equipment, improving the level of qualifications, preventive treatment, medical insurance, development in social spheres.

A successful enterprise should aim not only to make a profit, but also to carry out charitable activities. This will help to increase the number of customers and expand the recognition of the brand, such areas can be participation in social programs, environmental protection activities and resource conservation, development of the local population.

These indicators regarding the internal state of the enterprise will help to carry out a qualitative analysis of the activity.

The franchisee must understand that when conducting business under the franchise model, he does not lose all risks and they are not transferred to the franchisor. The franchisee bears the same responsibility for his activities as other entrepreneurs and business entities.

At the beginning of choosing a franchise or establishing a business, a franchisee may face such risks as [5]:

1. Lack of clear regulation and legislative, regulatory framework for franchising regulation.

2. Fiscal policy. A large tax burden can often make the franchise model economically unprofitable.

3. Lack of qualified personnel. The lack of a legislative and regulatory framework for franchising regulation reduces the interest of practitioners and entrepreneurs engaged in franchising in Ukraine and transferring their knowledge.

4. The specifics of consumer choice. In the Ukrainian market, consumers often do not rely on the choice of a certain brand, but stick to the price-quality ratio, so there is a lot of competition among various products.

5. Mistrust on the part of the consumer. Usually, consumers do not understand all the specifics of franchising, due to the lack of necessary information, which ultimately leads to distrust of franchising as an economic tool.

Conclusion

Therefore, the franchise market is diverse and saturated, so a problem arises for a potential franchisee when choosing it. To choose a reliable franchise based on the chosen type of activity and preferences, internal and external factors should be analyzed. External factors are market trends and conditions, trust, brand impersonality, knowledge transfer mobility, distinctiveness, adaptability, and knowledge documentation. Having analyzed external factors, the franchisee at this stage can reject a significant number of franchises, focusing on a limited range of specific enterprises and proceed to the next step - the analysis of internal factors. Internal factors are the capabilities of the chosen enterprise, the possibility of quick recovery of capital investments, the number of initial contributions, the efficiency of the management service and the responsibility of the enterprise.

Franchising in Ukraine is quite promising and conducting business according to this model reveals several advantages. Franchising has advantages not only for economic entities, but also for the state, as it leads to the expansion of jobs, an increase in GDP, significant tax revenues and international cooperation.

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