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FRANCHISE BUSINESS AS A GENERATOR OF DEVELOPMENT IN CENTRAL EUROPE

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Abstract
The franchise in the global marketplace enables many globally known brands. With its business concept, it enables integration, learning and acceptance of various cultural, historical, religious and other customs and habits. Consumers prefer a proven and expected standard product quality and services, no matter where they are, they expect and want the same quality provided by franchise companies (shops, restaurants, hotels, and others) of well-known brands in different places. It can be concluded that the franchise enables the transfer of business knowledge, experience and technology to an unlimited space. Franchise is largely present as a way of doing business in the world and it has an impact on national economies. Companies can use it as a strategic growth model, as a model for launching a whole new business. Since Croatia has enough potential to develop franchise business that is not sufficiently exploited, that potential could be largely exploited in addition to overcome certain problems. Conducting a systematic analysis of franchise business and development would contribute to this. This paper deals with basic concepts related to the franchise business, features and characteristics, advantages and disadvantages of franchise business, the impact it has on the national economy (US example), and a comparative analysis of the franchise business in Croatia compared to other Central European countries

Keywords: know-how, brand, royality, franchise.

Jel Classification: G32; L14; M55

INTRODUCTION

Franchising can be observed as a growth model for already existing businesses that have the growth potential, as well as a model for launching a new business that significantly reduces uncertainty and in certain measure risk. Self-initiate own new business (substantial start-up capital, lot of time to set up the profitable business), or buying an existing business entity (a significant initial capital required)—nowadays is more risky and harder, if investor wants to avoid some of the common start-up pitfalls, then a

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reasonable solution is to buy franchise (shorter time to start-up business, lower initial capital, significantly lower level of risk, safer but not guaranteed business future).

On the other hand, many companies use the franchise as a model for growth and expansion of their own business, strengthening their own identity and market position. Therefore, it could be concluded that the franchise is a good strategy for new or smaller companies (franchise users) which have better possibilities for business start-up or development, as well as for larger businesses (franchise providers) that have even more development opportunities. In other words, franchise enables good business results for both sides in the franchise system.

Oxenfeldt and Kelly (1968, 69) defined franchise as an "arrangement that mainly fosters the rapid growth of new businesses and permits the exploitation of marginal opportunities." According to Selde, Gipson, and Parker (2008, 5) "franchise may represent a shortcut to establish a new business opportunity." One of the most appropriate theories that discusses and explains the motives of franchise companies is the theory of resource scarcity (Andrew et al. 2007; Hsu and Jang 2009), this theory suggests that the franchising system can grow more quickly, (Oxenfeld and Kelly 1969) using other resources through the franchisee.

The franchise model of business has been successfully implemented for many years in developed countries. Therefore, there are also numerous papers tackling franchise business in the world. In Croatia there is no systematic analysis of franchise development, only few Croatian authors are engaged in exploration of franchise business. Purpose of this research is to educate, disseminate and popularize franchise business in Croatia. One of the aims of this paper is to examine advantages and disadvantages of franchise business, and to determine the current and the comparative relationship with other countries.

1. FRANCHISE IN THE FUNCTION OF BUSINESS ENTITY DEVELOPMENT

Its wide use started in 40s and 50s and nowadays franchising is one of the fastest developing types of business all over the world (Mendelsohn, 2005; Antonowicz, 2011).

A franchise is a business relationship in which franchisor is granting the right of sale of certain products or services within the designated territory in certain time period, or gives the franchisee the right to use his trade name, trade mark or brand, products or services, and franchisee uses his productive or service business knowledge and experience, or the way of doing business (depending on the franchise). Franchisee pays the franchisor a certain (initial) fee to acquire a franchise right for the use of a successful business system, and also pays a certain amount as a percentage of the realized sales of the product or service.

Franchising can be also defined as a method for the distribution of products and services that allows an independent entrepreneur (i.e., the franchisee) to acquire from the parent company (i.e., a franchisor that runs a network of outlets) the right to sell the products or services under its brand name and to use its business practices (Lafontaine 1992; Combs, Michael, and Castrogiovanni 2004; Pruett and Winter 2011). According to Andrew et al. (2007) franchising is a system in which the franchisor grants a license, trademark, and service mark, as well as advice, and assistance in organizing, merchandising, and managing the business as a long-term business relationship. In other words, franchising is a contractual inter-firm business relationship that is formed between a grantee (franchisee) and a grantor (franchisor) for selling the franchisor's product, using the franchisor's trademark and proprietary business system in a specified location for a specified period of time (Dant and Grunhagen 2014).

According to the International Franchise Association (IFA), franchising is "simply a method for expanding a business and distributing goods and services through a licensing relationship. In franchising, franchisors (a person or company that grants the license to a third party for the conducting of a business under their marks) not only specify the products and services that will be offered by the franchisees (a person or company who is granted the license to do business under the trademark and trade name by the franchisor), but also provide them with an operating system, brand and support."

The franchisee invests in an already proven business model with a system established by a franchisor with a structured set of operational procedures that usually reduce the risk considerably compared to the traditional business (Shane and Hoy 1996; Spinelli, Rosenberg, and Birley 2004). Franchising influences transfer of technology and business methods and offer of quality products and services at reasonable prices (Dwivedy 2002). According to Kotler and Keller (2006) franchises are distinguished by three characteristics: the franchisor owns a trade or service mark and licenses it to franchisees in return for royalty payments, franchisees pay for the right to be part of the system, and the franchisor provides its franchisees with a system for doing business.

The franchise relationship between the two parties is governed by a franchise agreement, whereby the franchisor is usually obliged to provide: professional and business assistance, advices, transfer knowledge and experience, ensure system operation, while the franchisee is obliged to strictly respect the standards of the organization and the way the franchisor operates.

The franchisor (usually a legal entity) grants the right business under its trading name, most often has a franchise business relationship with multiple recipients, thus ensuring the recognizability and quality of its products or services to consumers (their buyers) on a wider geographical footprint.

A franchisee (legal or natural person) is a business entity acting independently on its own behalf but under defined terms of the franchisor (who wants to retain the identity, reputation, value, quality and brand identity, brand name) which are regulated by contract. Although franchisors and franchisees are legally independent from each other, they share the same targets (Insa-Ciriza 2003; Berbel-Pineda and Ramirez-Hurtado 2012) and each side has its own interest.

In franchisee business the contribution of the franchisor in the franchise partnership model offers of a well-known product/brand and a successful business concept, while the franchisee contributes managerial expertise, local market knowledge and capital (Oxenfeldt and Kelly 1969). Lewandowska (2014) considers that the franchise is the economic relationship that the owner of the product, process or trademark (franchisor) gives to the other party (the franchisee) the right to use them commercially for the compensation or contractual benefit.

The franchise business's success stems from the franchisor interest that the franchisee (buyer) is making business success, because the franchisor will thus have a financial benefit (through agreed percentages of the franchisor's income). The recipient pays a franchise fee and pays royalties uninterruptedly, thus providing an uninterrupted source of capital for further growth and expansion of the franchise.

A franchisor who has long-standing successful knowledge and experience in the business sector that has a successful and recognizable product and/or service (name/brand), an effective and recognizable whole business concept—may think whether he will expand his business in another area by opening its own affiliates, or decide to offer a local company a franchise. In second case, the franchisor shares the costs, the risk, and the results of business growth with the franchisee, who becomes his business partner. Depending on the type of business and activity of the franchisor, and whether the franchisee has a real estate property or not, the initial costs can be varied in a wide range. Franchise costs are carried by the franchisee, and the risk of starting a business and costs of funds also. The franchisor „has to develop its own sales team for development and support of the franchising network, aiming on maximizing profits, which ultimately increases the income and number of employees“ (Alpeza, Erceg, and Oberman Peterka 2015, 10).

However, a verified business model that works in some area don't guarantee equally good and successful results in another area (different competition, different consumer standards, different consumer habits, mentality, culture, religious or other customs, etc.). Therefore, when buying a franchise and considering a franchise offer, franchisee must well know the local market and consider whether this business idea is really a good business opportunity at a certain location (using financial analysis and calculation of entry into a business venture, etc.).

2. PURPOSE OF FRANCHISING

The many benefits of franchise business are good motivation for franchisee and franchisor. Some of the major advantages for franchisor are faster business expansion, use of others' financial resources (investment rationalization), better management capability, taking part of business risk, better use of local market conditions (franchisee is more familiar with market opportunities in the local area, so he can better benefit from it than franchisor), greater engagement and motivation through increased turnover and profits, and therefore greater engagement through finding new partners (franchise recipients).

The franchisor can thus achieve higher and faster growth, with rational use of own capital and rationalization of business and financial risks (with less investment, lower risk, new locations in the wider area where brand strengthens and promotes, name, product / service, business concept of the franchisor), while increasing the income, value and dignity, the financial position of the franchisor itself, as well as the value of the franchise system for which new franchisors will be interested. Therefore, faster growth leads to economies of scale with minimal investment (Maitland 2000; Shane 2005) where franchises provide three major resources: managers, money and time.

Some of the significant benefits to franchisee are the use of a proven and successful business concept (if it is included in contract), a proven and successful brand, a well-known and unique business image, the use of educational services, training, counseling, assistance, consultancy services (especially if the franchise recipient has no knowledge and experience). The amount of initial capital investment is compensated with the benefits of supplying production and / or service resources (availability and prices of raw materials, rebates, centralized procurement of raw materials), availability of market research results (available quality information such as potential purchasing power of potential customers, niches, prices and conditions of sale of competition, real demand, legislation, standards, etc.), and there is also the possibility of lending from the franchisor.

Since the subject of the franchise agreement is a verified, successful, standard product, service, business concept, and trademark, and the contract includes assistance in selecting the location, training and staffing of employees, advices and assistance in the procurement and arrangement of sales or service space , taking technology, i.e. the entire business process and proven business procedures—when all the defined elements of such a contract are taken into account, the risk of unsuccessful business is smaller.

Disadvantages in franchise business for franchisor are reflected among other things in the loss of control over the franchise business units (unlike their own offices) where the franchisor is not the owner of the franchise location, and the right of management is retained by the franchisee who fully operates independently. In the case of a franchise business, certain problems may arise in business relation with the franchisor in the sense of non-compliance with the contractual obligations, non-compliance with the standard procedures and business rules, creating their own policies and ways of doing business, non-objective reporting on incomes, and hence a reduced percentage in incomes which franchisee pays to franchisor. There is also a realistic possibility that after the expiration of the franchise agreement, the franchisee becomes a competitor to the franchisor in a way that he develops his own product or service (based on acquired knowledge, business experience, business process, etc.).

The biggest drawback in franchise business for franchisee is long contractual business obligation that franchisee must strictly adhered to, and such a liability is most often related to the long period. Regardless of the invested funds by the franchisor, the contractual obligation of the franchisee is to pay exactly the contracted royalties or royalties from the realized turnover, which leads to the fact that the franchisor does not participate equally in deciding on the division of profits from the realized business activity, therefore they are not equal partners. Furthermore, the franchisee financial obligations are mandatory, irrespective of the realized turnover. Weinrauch concluded that (1986, 1) „the owners of established small businesses are often attracted by the prospects of achieving increased growth and profitability through franchising. Well-publicized, "rags-to-riches' stories about successful franchisors have helped to create the illusion that this form of organization offers a quick, easy shortcut to business success.“ The economic impact that franchise business has on the world economy is manifested (Alon, 2006) in output and creation of new jobs, increase of tax base, economic modernization, development of small and medium entrepreneurship, and acquisition of new skills and abilities. „Franchising at its best is a partnership which establishes trust, opens communications, and accrues benefits to both the franchisor and its franchisees.“ (Antonowicz 2011, 9). Stanley Dreyer (Vice President National Cooperative Bank, Washington) stated that „franchisees also form a natural group for a formal or informal cooperative effort and gain the natural benefits of group purchasing power“ (1998, 13) and franchise business contributes to the establishment of trust, good communication and benefits for both sides in the franchise relationship, and success means—growth and increased profitability of the franchise. This business model became an effective opportunity for small tourism enterprises, which cannot afford to finance their development (Dant and Kaufmann 2003). Although the franchise business has its many advantages, "the franchise cannot quickly solve all the problems and fully secure business success" (Mahacek and Martinko Lihtar 2013, 605). “Sustainability of the franchise business model depends not only on economic sustainability, interpreted as financial success of franchised outlets, but also on meeting the franchisee’s needs through formal governance mechanisms to ensure stable, enduring franchisor-franchisee relationships and the economic sustainability of the chain“ (Calderon-Monge, Pastor-Sanz, and Huerta-Zavala 2017, 11).

3. COMPARATIVE RELATIONS OF FRANCHISING

Although the franchise as a business concept is present in Croatia, it has not yet achieved its full potential. According to Erceg and Cicic (2013) the franchise business in Croatia is estimated at an early stage of development, and it is necessary to act on entrepreneurs to expand this business model as a way of growth and business expansion (franchise providers) or independent entry into entrepreneurship (franchise recipients).

In order to improve the development of franchise business in Croatia and to emphasize its potential role in strengthening the competitiveness and export potential of the Croatian economy CEPOR (Centar za politiku razvoja malih i srednjih poduzeca i poduzetnistva [Small and Medium Enterprises Development and Entrepreneurship Policy Center]) in cooperation with the Croatian Franchise Association, Franchise Center and the Center for Entrepreneurship Osijek, organized a roundtable on subject “Increasing the competitiveness of the Croatian economy in the EU through franchise construction” in 2012. On the round table it was ascertained that one of the biggest obstacles to the analysis of franchise business in Croatia is the lack of information on the number of domestic and foreign franchise systems. It was also pointed out that Croatia has a lack of a legal framework regulating franchising in the context of ineffective legal systems and that makes an obstacle for both—franchisor and franchisee. Except limited access to financial resources for the franchise purchase in Croatia, in the segment of financing, additional difficulties are related to the poor level of bank information on the specifics of the franchise business (banks do not yet apply an adequate approach in the customer's franchise analysis when making a loan decision). The following problems and obstacles to the development of franchise business in (from the conclusions of the round table in franchising) Croatia are highlighted: lack of legal framework for franchising; absence of evidence/register of franchise systems in Croatia (domestic and foreign); lack of analysis of the state of affairs and strategy of franchise business development; poor level of education about the benefits of franchise business among entrepreneurs and growing businesses; poor infrastructure support for the development of franchise business due to the low level of education of lawyers and business advisors; lack of understanding of the specificity of franchise business in financial institutions and as a consequence of inadequate access to franchise financing; poor representation of the issue of franchise business in the formal education system. Alpeza, Erceg, and Oberman Peterka (2015, 6) have identified “obstacles and challenges to a wider application of franchising in Croatia and they have generated policy recommendations for removing the identified obstacles. Obstacles and recommendations are identified on the basis of a conducted longitudinal qualitative research, the first phase of which was conducted in 2006, and second in 2014.” The obstacles can be divided in two categories: franchising specific barriers and general business-related obstacles for doing business in Croatia. They have concluded that without removing most of these obstacles, it would be unrealistic to expect in the future a large increase of franchise activity in Croatia.

In the purpose of promoting the franchise model in Croatia, very active organizations were established during 2003 - the Croatian Franchise Association (EFF member since 2006. and the World Franchise Council), and a franchise center (Center for Entrepreneurship in Osijek) and the Promaturo Franchising Center in Zagreb, which represent organizations where information about franchising can be obtained. and through which it is possible to establish contact between potential recipients and franchisees, and also organize franchisees seminars, participate in franchise promotion projects, and cooperate with all major franchise providers in Croatia. Using the before mentioned organizations contacts can be established between potential franchisees and franchisors. In addition, they organize franchise business seminars, participate in franchise promotion projects, and cooperate with all major franchise providers in Croatia.

In 2017, the Croatian Chamber of Economy and the County Chamber of Rijeka organized Franchise Expo, financial and consultancy services (Franchising Exhibition Croatia) where was highlighted that the franchise sector generates more than 50% of the world's retail trade worldwide and the franchise industry in Europe is worth 350 billion euros and employs more than 3 million people. Research in the EU has shown that in Italy, 96% of franchise brands are national, in Slovenia 48%, and that Croatia is the last in Europe with only 12% of its own brands in franchise business. About 200 franchises are currently on the Croatian market with 17,000 employees in more than 1,000 locations, of which only 20 are domestic, including the popular local franchise Surf'n'Fries, Place2Design, Bio & Mlinar, DiCaprio and others. One of the most successful franchises in Croatia is Surf'n'Fries (they offer a variety of fries and dips), they have spread its brand to 15 countries from Russia to Vietnam. Another successful franchising story from Croatia is Mlinar, bakery industry, which has expanded franchise in Slovakia, Switzerland and Australia.

In the world as well as in neighboring countries, franchise is increasingly being used as a business model. As modern business activities are increasingly focused on the service sector, franchising is expected to follow these trends (employment services, education, bookkeeping, home improvement, cleaning), and franchise development is most anticipated in the field of tourism and hospitality.

3.1. Current state of the U.S. franchise market.

According to a comprehensive research study of the International Franchise Association, Education and Research Foundation (IFA 2016) on the economic impact of franchising, there are 732,842 business format franchise establishments providing more than 7.6 million jobs, generating $674 billion in economic output and 2.5% of the Gross Domestic Product (GDP) for the U.S. economy. The study shows the total franchise establishments, jobs, output and GDP and the economic contributions of franchising to the U.S. economy at the national, state, and congressional district level. Statistics are provided by business line and include the direct and indirect economic impact. According to the aforementioned study, franchise jobs have provided more work in 2016. than wholesale trade; transport and storage; manufacture of non-usable goods; (including software and printing, film and video, radio and television broadcasting, telecommunications operators and resellers); Considering the indirect impact of franchise companies, the franchise in business format supports more than 13.2 million jobs, $ 1.6 trillion in economic production for the US economy and 5.8 percent in gross domestic product (GDP).

The number of franchise employees is the largest in California, Texas, Florida, Illinois and Ohio; Franchises own and operate in 88% of all business franchisees. Despite the aforementioned sectors, only finance and insurance have provided more jobs than franchise companies. Franchise companies have created record number of jobs, generated opportunities and economic growth in communities nationwide (IFA 2016, Table 2).

Table 1. Jobs by Selected Economic Sector in 2016

Sector	Jobs
Financial and insurance	10,191,600
Franchise businesses	8,968,000*
Real estate and rental and leasing	8,461,900
Durable goods manufacturing	8,181,800
Wholesale trade	6,554,900
Transportation and warehousing	6,537,700
Nondurable goods manufacturing	4,963,600
Information	3,363,300

*Note: *Includes both business format and product distribution franchises.*

According to study, Business Format and Product Distribution Franchising—Business format franchises sell the franchisor's product or service, with the franchisor's trademark, and operate the business according to a system provided by the franchisor. Franchising as a business format is more prevalent than product distribution franchising, accounting for almost 11 times as many establishments and more than five times as many jobs in 2016. Franchisees owned most (88%) of the establishments that operated under a business format franchise. It has the economic significance in the ten business lines. Figure 1. shows the estimates of economic activity in franchise companies in each of the ten business lines of business forms, classified by direct business.

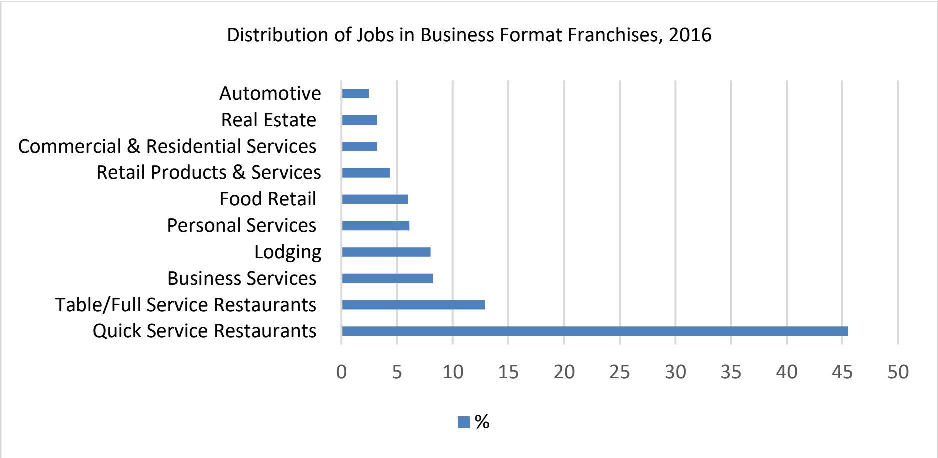

Figure 1. Distribution of Jobs in Business Format Franchises, 2016

More than any other business line (IFA 2016) Quick Service Restaurants have provided more business premises, jobs, and payroll, and they had achieved high production and contributed to GDP more than any other business line (45.5% is the share of quick service restaurant in total of all jobs in business format franchises). On the second place is Table/Full Service Restaurants with 12.9% of all jobs in business format franchises, followed by business services with 8.2%, Lodging 8%, Personal services 6.1%, Food retail 6%, Retail products & Services 4.4%, Commercial & Residential Services 3.2%, Real Estate 3.2% and Automotive 2.5%.

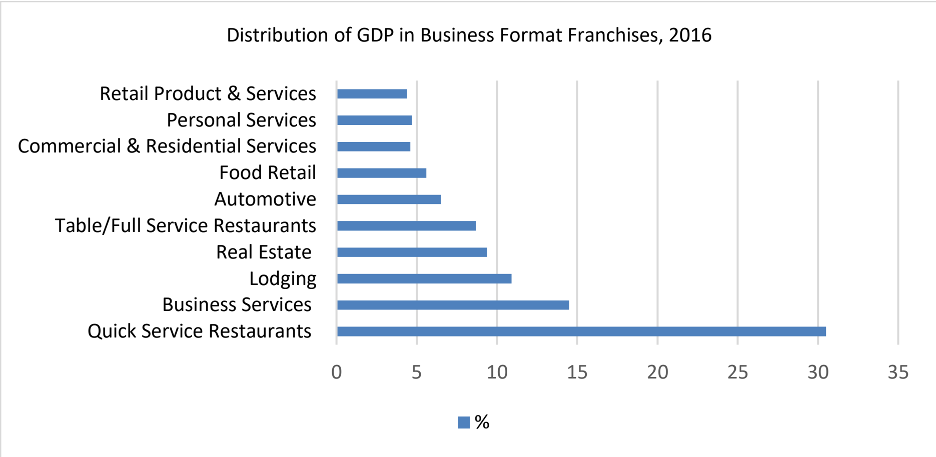

Figure 2. Distribution of GDP in Business Format Franchises, 2016

According to IFA report Quick Service Restaurants accounted for 30.5% of total GDP in business format franchises, followed by Business Services 14.5%, Lodging 10.9%, less than 10% have (Real Estate, Table/Full service Restaurants, Automotive, Food Retail, Commercial & Residential Services, Personal Services, Retail Product & Services) which is shown in Figure 2.

3.2. Current state of the Croatian franchise market compared to the countries of Central Europe

Representation of franchise brands in Croatia and other Central European countries is illustrated in the following picture (according to European Franchise Federation, Aug. 2015.

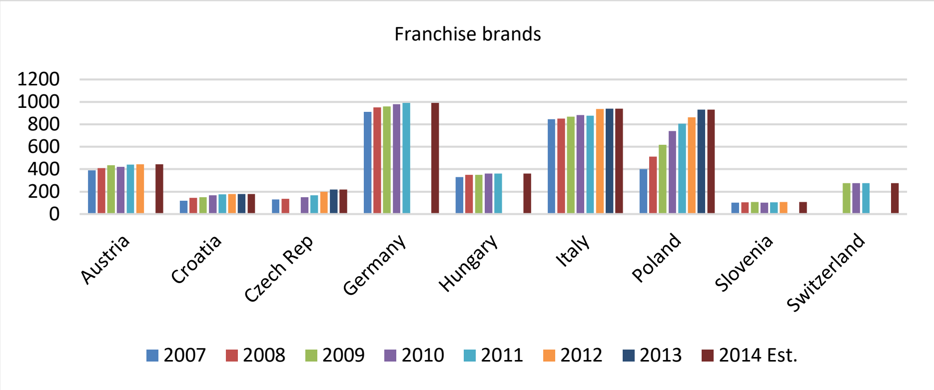

Figure 3. Franchise brands for selected countries of Central Europe, 2007–2014

From the data presented in Figure 3, the countries represented by franchising brands in the countries of Central Europe are: Germany (990), Italy (939) and Poland (930), followed by Austria (445) and Hungary (361), and finally Switzerland (275), Czech Republic (219), Croatia (180) and Slovenia (108). No country has recorded a significant decline in franchise brands.

Representation of franchise outlets in Croatia and other Central European countries is shown in the following figure (according to European Franchise Federation, Aug. 2015).

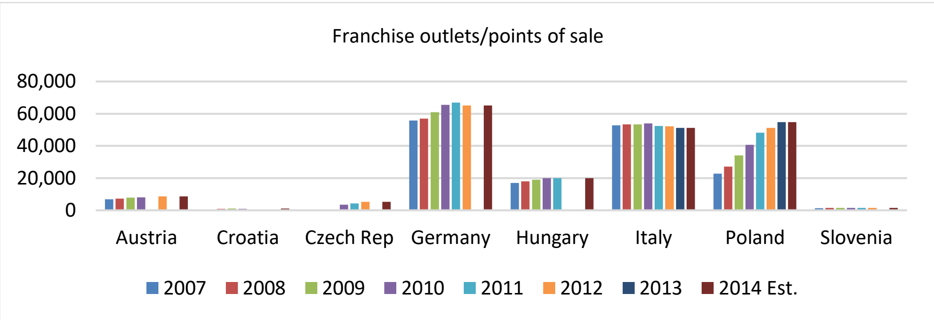

Figure 4. Franchise outlets/points of sale for selected countries of Central Europe, 2007–2014

Figure 4 show the country by number of franchise stores, according to last available data Germany has 65,059, Poland 54,750, Italy 51,110 followed by Hungary 20,000, Austria 8,720 and Czech Republic 5,299. Lowest number have Slovenia 1,580 and Croatia 1,000. No country has recorded a significant decline. According to Nugroho (2017) "after business functions of the franchise system are proven and ready to be duplicated, franchisor's main job is to monetize it by adding as high as possible number of outlets."

The turnover for franchise sales centers (in EUR) in Croatia and in the selected Central European countries is shown in the following figure (according to European Franchise Federation, Aug. 2015).

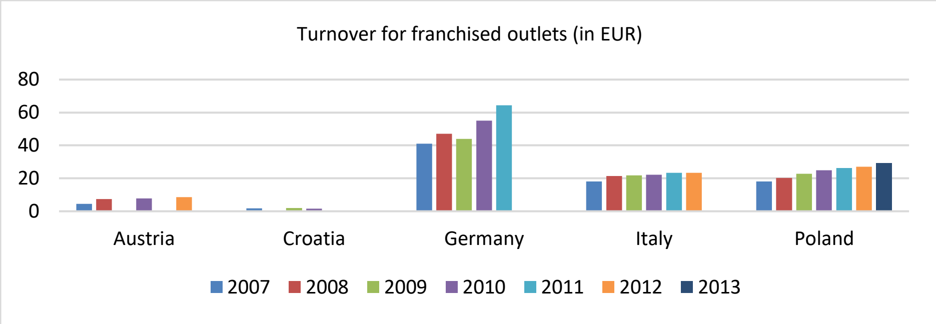

Figure 5. Turnover for franchised outlets for selected countries of Central Europe, 2007–2013

Croatia has achieved very low results in the realized turnover for franchised outlets in relation to the selected countries of Central Europe (although the data for certain years are unknown). The largest turnover is achieved by Germany, Italy and Poland, and it is also clear that Poland continuously grow year after year. No country has recorded a significant decline, as is indicated by Figure 5.

Employment for franchise outlets in Croatia and other Central European countries is shown in the following figure (according to European Franchise Federation, Aug. 2015).

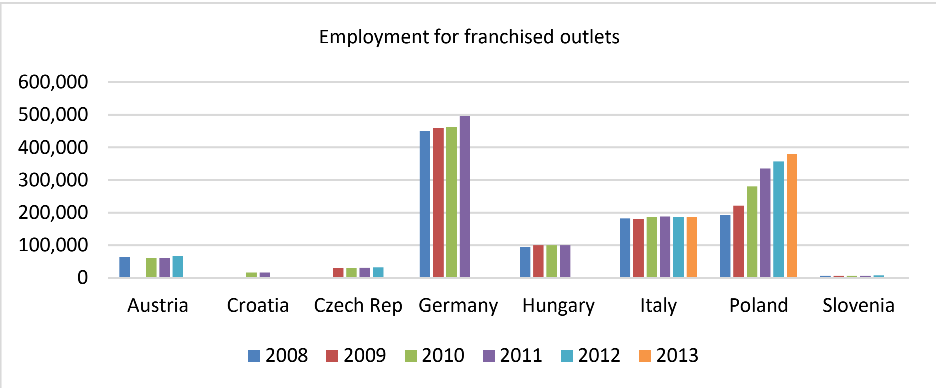

Figure 6. Employment for franchised outlets for selected countries of Central Europe, 2007–2013

Figure 6 illustrates that Croatia compared with other Central European countries has achieved very small employment for franchised outlets. Worse results than Croatia only Slovenia achieved. From this figure it can be noted that Germany and Poland are continuously growing year by year, while other countries are stagnating through years of observation. No country has recorded a significant decline.

CONCLUSION

Croatian companies did not fully accept the franchise as a model of business expansion or as a significant form for starting a business due to inadequate information, insufficient knowledge and experience in franchise business, regulatory environment (franchise business in Croatia is not fully regulated, only certain elements are identified), and the lack of interest and support of indirect participants in franchise business (banks, institutions, legal services, consultants). The interest in franchising business is growing daily, so it is clear that—this way of doing business will gradually develop in the future in Croatia and will involve other parties who are also part of the business. Therefore, it is necessary to adopt adequate legal regulation in Croatia, to educate businesses and entrepreneurs about such business, and to provide financial and credit incentives for franchising. The economic impact of franchise business on the US economy is evident because it makes 2.5% of gross domestic product, which includes 732,842 business franchise facilities that provide more than 7.6 million jobs, and generate $ 674 billion in economic production. The strongest countries in terms of franchise brands, number of sales outlets, have generated a turnover by franchise sales centers and employment results for franchise outlets in Central European countries are Germany, Italy and Poland.

Analyzing and examining the current state of franchise business in Croatia (although recent data are unavailable, Croatia has been analyzed for period 2007–2013) with respect to Central European countries, the results show that only partially but insufficiently, Croatia follows the global trend of development of the franchise business. This type of business due to its characteristics and good features, needs to be encouraged in order to achieve positive growth in Croatia.

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