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International Franchising

The development of an international network can take many forms:

- Privately-owned network
- Direct franchising
- Master franchising
- Area development
- Joint venture

On the following pages, we give a short presentation of each form and its associated advantages and disandvantages. Irrespective of the form chosen, it is often the case that international expansion will be preceded by the founding of a branch or a subsidiary in the foreign country.

Privately-owned network

The successful development of a privately-owned network needs substantial financial and human resources. In addition, this form of international expansion is very time-consuming since, even very large companies, do not have the needed resources to embark on the simultaneous development of many networks internationally. On the other hand, if successful, a privately owned network is a solid base on which a franchise network can be developed.

If the decision is taken to develop a privately-owned network abroad (which can take the form of a branch or subsidiary company) the following issues need to be faced:

- finding and educating staff abroad;
- adapting the methods and operating modes of the company to the customs and business norms of the foreign country. For this adaptation, local staff will probably be needed, who know the foreign country very well.
- supervision and control of the network in the foreign country.

Direct franchising

In this case, the franchisor finds franchisees in the foreign country directly, without the intervention of a third person. This form of international franchising is suited only in cases where the foreign country is geographically close, shares similar business customs, and it is not expected that a large network will be developed. On the hand, it is not suitable when the foreign country is far away, has a different culture and a large network will be developed.

The most important obstacles are:

- the language;
- the local, different legislation;
- cultural differences;
- different consumption patterns;
- as a result of the above, the need to adapt the franchise to local habits and business methods.

In any case, a prerequisite for successful development is the establishment of a pilot store through which to explore the culture, business methods and opportunities of the foreign country.

Master Franchising

A very common form of international expansion is master franchising. In this case, the franchisor gives to the foreign master franchisee the complete rights for the development and the operation of the franchise network in the latter's country. The master franchisee can then develop the network either with privately-owned stores or through a franchised network. The issues that need to be examined are:

- the difficulty to locate the suitable person to become master franchise;
- the availability of the proper infrastructure at the franchisor's head office – in human and financial terms – with which to support the needs of the master franchisee;
- the adjustment period necessary, before full synchronisation is attained with the foreign master franchisee.

On the other hand, master franchising has considerable advantages as the master franchisee has better knowledge of the market and culture of his country and can, therefore, adapt the franchise in the local conditions.

Also, communication is greatly facilitated since there is only one person to communicate with (the master franchisee), and not many (the franchisees). However, it is very important to establish some communication with the franchisees who consist the network's front line in the market and, hence, are the ones that first get its message. For this reason, it is advisable that the franchisor participates in the franchisees' annual meetings, so as to understand the pulse of the market and the network. On the other hand, under no circumstances, should the impression be given that he substitutes the function of the master franchisee.

Particular attention must be given not only to the choice and training of the master franchisee but also of the franchisees the latter will choose.

Finally, the remuneration of the master franchisee should derive from the split of the franchise fees between the franchisor and the master franchisee. The only constant parameter in the negotiation for the split, is the total level of the franchise fee – normally equal to the franchise fee in the franchisor's country – which is the source of the fees of both parties. The split between the two parties is part of their negotiation.

Area Development

Often and in order to avoid, on the one hand, the complexity of direct franchising abroad and, on the other hand, being dependent on only one partner (the master franchisee), expansion through the method of area development is chosen. This method has important advantages when:

- the market is segmented and each area has its own peculiarities;
- the market is very big. In such a situation where development of the market demands substantial financial resources, finding many area developers is much easier (not easy though) than finding one master franchisee. In addition, through area development agreements, the risk of failing to develop the network is spread out – since there are numerous area developers. In addition it is possible to benchmark the area developers among them.

Adoption of the area development method requires special attention in determining the operating and liability limits of each area developer, so as to avoid developing parallel networks within the same area at the same time.

One of the more frequent risks associated with area development is that of the area developers – who no doubt control the network – taking joint action against the franchisor in an effort to restructure agreements to their benefit.

Joint Venture

Sometimes the legal framework of the host country makes the establishment of a joint venture necessary, e.g. when substantial tax advantages are given to joint ventures between a local and foreign partner. As in all joint ventures – which in franchising normally takes the form of a joint business – the choice of a suitable partner is very important. In addition it is very important to determine:

- the shareholding of each party in the joint company and
- its responsibilities

- as well as the development plan of the company. This development can of course take the form of master franchising or area development, in which case all the above mentioned issues have to be examined.

The establishment of any cooperation and more so the beginning of a joint venture, takes place because of the good prospects it offers. Nevertheless, it makes sense at this point where everything looks "rosy" to think and agree on the ways to dissolve the Joint Venture in case if it proves unsuccessful. Particularly so as the local partner will not be just an investor, but will also undertake a substantial managerial role in the Joint Venture.

Branch or Subsidiary Company

Legal or commercial considerations often dictate, that in order to be present in a foreign country, it is necessary to establish one or more local branches or a subsidiary company. Therefore, the branch or the subsidiary are not forms of international franchising but the tools employed to establish presence in a foreign country.

In cases of international expansion by franchising, the franchisor normally establishes a branch:

- when he franchises directly and controls the network through the branch;
- when he uses the branch as a local base for servicing the network.

Respectively, the franchisor establishes a subsidiary company:

- when he franchises directly and controls the network through the subsidiary company;
- when he uses the subsidiary as local base for servicing the network;
- when he grants the subsidiary the rights of a master franchisee. The subsidiary can be a joint venture with a local businessman and makes it technically – and commercially – easier to sell part or all of the foreign operation when a good opportunity arises.

Bibliography

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