

## FRANCHISING BUSINESS MODEL: AN EXPERIENCE FROM THE INDIAN RETAIL INDUSTRY

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### **Abstract**

*This study developed a model for examining the factors that result in the overall satisfaction of the franchisees in Indian retail industry. The developed model was empirically tested using a sample of retail franchisees in Bengaluru city. The questionnaire was drawn from a multi-stage process involving extensive review of literature and in-depth interviews. After validation by the experts, it was administered to the franchisees that were selected based on convenience sampling. The data was analyzed using multiple regression analysis. The findings suggest six key franchisor inputs that can contribute for franchisee satisfaction: Brand Value, Training, Operational Support, Communication, Contractual Integrity and Financial Returns. The results show that, the franchisees were generally satisfied with their franchisors. They were also positive about the franchise brand. It is suggested that franchisors do more of local marketing, promotion & training. It adds to the existing literature on Franchising in India and contributes to the success of franchising as a business model.*

**Key Words:** *Franchising, Franchisor-franchisee relationship, Retail, Satisfaction.*

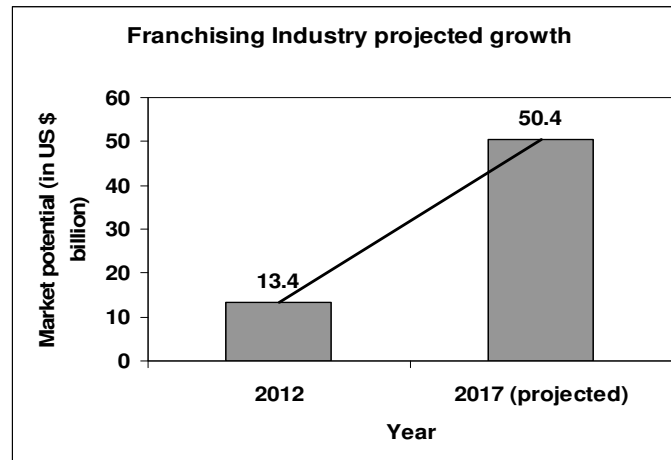
### **Overview of Franchising**

Small business plays a crucial role in a nation's growth. But establishing a new small business involves risks and challenges. Franchising as a business model reduces the risks of managing a small business. The Indian Franchise Association (IFA), defines a "franchise as a continuing relationship in which the franchisor provides a licensed privilege to do business to the franchisees, plus assistance in organizing, training, merchandising and management in return for a consideration." The franchise relationship is inter-dependent, as both the franchisor, who lends his trade name and business system, and the franchisee, who pays for the right to do business under the franchisor's name and system, stand to mutually benefit. Franchisees purchase the franchisor's experience in the form of a successful business model. The franchisors charge fees and royalties, from the franchisees, in exchange for the services provided by them. Franchisees benefit from the franchisor's business experience. The ideal franchisor-franchisee relationship is one built on mutual trust, consideration, and cooperation, and is vital for the success of both parties in developing a win-win relationship. The termination of a franchisor-franchisee relationship has many implications both for the franchisor & franchisee. A better understanding of the factors that produce a high-quality relationship between franchisor and franchisee would be beneficial to both parties.

### **The International and Indian Scenario**

USA is the leader in the world of franchising with close to 83 of the top 100 franchised brands globally. Employment generated by the franchising sector also has been growing over the last 4 years in the US suggesting the immense potential for the sector to contribute to job creation. McDonald's is the greatest success story of franchising business model. There are 1.5 million franchised outlets, accounting for approximately one-third of all US retail sales. Franchising is growing at roughly 6 percent per year, with franchises replacing independent businesses.

Franchising, as a way of expansion in India was little known till the 1990s. But ever since the liberalization in 1991, in India too, the franchised businesses are increasing. MNCs and national players are implementing franchise models to achieve their strategic growth targets in the India. India has a very great potential for franchising in organized retail. According to Gaurav Marya (2012), the Indian franchising industry, today, is estimated to be around Rs. 10,000 crore with about 1,500 homegrown franchisors and is growing at a rate of 25 percent annually. Many Indian franchisors have adopted the route of franchising for their expansion successfully. The Indian consumption story is driven by the demand from the huge middle class. According to a recent KPMG and FAI (Franchising Association of India) report, Collaborating for Growth – Report on Franchising Industry in India 2013 (2013), the Indian Franchising Industry is expected to quadruple in the period 2012-17 from \$12.4 billion to \$52 billion. This is going to contribute about 4 percent of India's GDP, increasing from a current 1.4 percent of GDP. The report also points that, retail is expected to emerge as one of the high potential service sectors within franchising to cater to the prevailing consumption boom. KPMG in India estimates that over 43000 franchisee establishments (valued at \$36 billion) may be required by 2017, to meet the growing demand in the retail sector from a current base of 13,000 (valued at \$10.6 billion).



Source: KPMG in India Analysis (2013)

### Retail Sector in India

Organized Retail is one of the sunrise sector and the fastest growth sector in the next decade. The overall retail sector growth is likely to witness a CAGR of 12-13 per cent, which would be worth INR 55 trillion in 2018-19. The Franchising Industry has great potential going forward and is going to be a significant contributor for the growth of GDP. The franchising industry is expected to employ 1.4 crore people by 2017, which is almost 10 percent of the total estimated workforce in that year. The organized retail is largely concentrated by retail franchisors in the Apparel, Consumer Durables and Food & Groceries space with around 80 percent share. However, India drives only about 2.5 percent of total retail sales through franchise formats, as against nearly 50 percent in the US, indicating huge potential for the market in future. Today India is home to more than 3000 brands which adopt the franchising model. Bata, one of the leading footwear companies, was among the first franchisors in India.

### Need for the Study

Franchisee satisfaction is important for the success of the franchise system. To contribute to the success of the franchise, it is necessary to ensure that franchisees are satisfied with the support of the franchisor. Because of dissatisfaction with their franchisor, when contracts expire and the franchisee chooses not to renew the contract, then years of relationship with the franchisor become useless. Better understandings of the factors that produce a high-quality relationship between franchisor and franchisee have to be understood, especially in the Indian context. The limited research on franchisees' perceptions of their franchisors, in Indian scenario, in the Retail industry, is not adequate. Therefore, in the current study an attempt has been made to understand the impact of these factors on the franchisor franchisee relationship, and satisfaction.

### Literature Review

Much of the research in this area is done in US and other developed countries. In India, this area is not widely studied yet. In a work carried out by Nerilee Hing (1995), she proposes that franchisee satisfaction influences the performance of the franchised outlet. The study based on an empirical study conducted on 127 franchisee owner managers, in Australia, has identified a set of 'Initial franchisee support services' and 'Ongoing franchisee support services' contributing to franchisee satisfaction. An empirical study, by Kimberely A. Morrison (1997), analyzed 307 US franchisees in four industries which showed a very strong positive correlation between franchisee satisfaction and performance, franchisor relations & intentions to remain. In a study conducted in Taiwan, it was discovered (Jyh-Shen Chiou, Chia-Hung Hsieh, and Ching-Hsien Yang, 2004) that communication is very important for the franchisees' satisfaction. The study developed and empirically tested a model examining the factors responsible for franchisees' overall satisfaction and concluded that, 'franchisor competitive advantage' is a very important factor for the success of the franchise system.

A. Berndt (2009) conducted a research on franchisees satisfaction levels among food franchisees in South Africa. The study concluded that a majority of franchisees (93.5%) rated their franchise system as average or better. The areas of concern were related to the training offered to the franchisees and financial expectations. Anil Saraogi (2009) has done a study about the selection criteria used by the franchisors in the selection of potential franchisees. The study has empirically demonstrated that the franchisors should select the franchisees who are more cooperative and less opportunistic for a successful relationship. According to Greg Nathan (2010), there are predictable patterns in the franchise relationship and proven strategies that franchisees and franchisors can adopt to manage their relationships very effectively.

### Objectives of the Study

The research objectives of the study are:

1. To analyze the factors that result in the success of the franchisee.
2. To build a model of determinants of franchisees' satisfaction.
3. To assess the perception of the franchisees' towards franchisor inputs.

### The Conceptual Model

The exploratory interviews with the franchisees were conducted to solicit the most important services assistance expected from their franchisor. Based on findings in the literature, discussions with specialists and suggestions obtained from respondents participated in the exploratory interviews, the relationship model was developed.

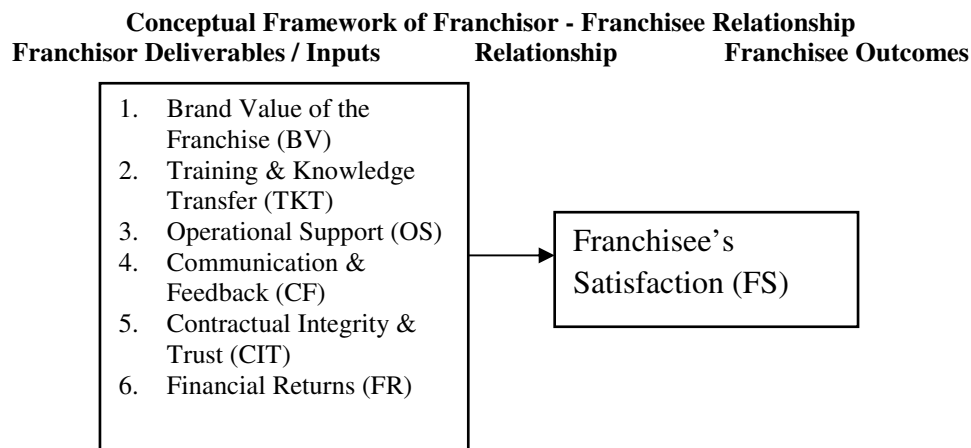
### Independent Variables

Brand Value of the Franchise, Training & Knowledge Transfer, Operational Support, Communication & Feedback, Contractual Integrity & Trust, Financial Returns.

### Dependent Variables

Franchisee's Satisfaction.

A conceptual framework was developed with the following 7 factors that are important in a franchisor-franchisee relationship:



### Hypotheses of the Study

Based on the theoretical framework, the following Hypotheses were formulated:

- H1:** Brand value of the franchise relates significantly and positively to the franchisee's satisfaction.
- H2:** Training and Knowledge Transfer relates significantly and positively to the franchisee's satisfaction.
- H3:** The operational support services relates significantly and positively to the franchisee's satisfaction.
- H4:** Communication & feedback relates significantly and positively to the franchisee's satisfaction.
- H5:** Contractual integrity & trust relates significantly and positively to the franchisee's satisfaction.
- H6:** Financial returns that the franchisor helps generate from the business, relates significantly and positively to the franchisee's satisfaction.

### Data Collection

Convenience sampling method was adopted for the survey. Franchisees in the retail Industry were known through personal contacts and other network sources. A convenience sample of 342 franchisees, from retail franchisees, was selected from Bengaluru City. The questions in the questionnaire were designed to tap the franchisees' perceptions of the relationship with his franchisor. The franchisee survey forms measured the 7 factors, in the model using 52 questions. Each question in the questionnaire was written in the form of a statement for which the respondent has to give his level of agreement. The scale used is a five point Likert scale for all the statements. Respondents were asked to rate each item on a five-point scale ranging from 1, "Strongly Disagree" to 5, "Strongly Agree." The data was collected, predominantly, through personal interviews and also with the use of a Web-based questionnaire. The survey responses were coded and analyzed using Excel & SPSS.

### Demographic Profile of Respondents

Majority of the franchisees were male (95%) in the age group of 25-45 (mean = 29). The education background of the franchisees ranged from SSLC to MBA with a majority of them (60%) having a bachelors degree. Majority of the franchisees (80%) were into the retailing of fashion apparels, the other (20%) were into the business of retailing footwear. 20% of them were into the business for less than an year were as a majority 40% were in the business for more than 3 years.

### Summary Values of all the Factors

Data analysis was carried on all the factors, by calculating the summary values for all the factors. The findings are presented in the following Table 1. The findings show that the franchisees have a high level of overall satisfaction with their franchisor (mean = 4.25). The franchisees are also positive about the factors 'Contractual Integrity & Trust' (mean = 4.08), 'Communication & Feedback' (mean = 4.03), 'Brand Value of the Franchisor' (mean = 4.11). There appears to be scope for improvement in the factors 'Operational Support Services' (mean = 2.79), 'Financial Return' (mean = 3.89) and 'Training & Knowledge Transfer' (mean = 3.92).

**Table 1 - Summary Values of all the Factors**

S. No	Factors	Mean Value	Std. Dev
1	Brand Value of the Franchisor	4.11	0.91
2	Training & Knowledge Transfer	3.92	0.94
3	Operational Support Services	2.79	1.09
4	Communication & Feedback	4.03	0.70
5	Contractual Integrity & Trust	4.08	0.72
6	Financial Return	3.88	0.68
7	Franchisee's Satisfaction	4.25	0.77

### Impact of Franchisor Inputs on Franchisee Satisfaction

To understand the association between franchisees satisfaction and the other independent variables in the model, multiple regression analysis has been used and the results are presented in the following Tables 2 and 3.

**Table 2 - Impact of Franchisor Inputs on Franchisee Satisfaction – Model Summary**

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.490 <sup>a</sup>	.240	.226	.49360

a. Predictors:(Constant), Return, Brand, Trust, Support, Communication, Training

**Table 3 - Impact of Franchisor Inputs on Franchisee Satisfaction – Model Coefficients**

Coefficients <sup>a</sup>							
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Remark
		B	Std. Error	Beta			
1	(Constant)	1.266	.303		4.178	.000	S*
	Brand	.182	.058	.194	3.124	.002	S
	Training	.096	.071	.091	1.364	.173	NS
	Support	.074	.042	.102	1.774	.007	S
	Communication	.159	.059	.150	2.688	.008	S
	Trust	.180	.059	.161	3.046	.003	S
	Return	.191	.047	.209	4.083	.000	S

a. Dependent Variable: Satisfaction

\*(Note: S = Significant, NS = Not Significant)

The results of the regression analysis reveal that the correlation coefficient (R) value is 0.490, which exhibits a good level of prediction between the Independent variables and dependent variable. The R Square ( $R^2$  value) value is 0.240. Coefficient of determination ( $R^2$ ) describes the amount of variability explained by the whole of the selected predictor variables and the result indicates that the independent variables are predicting 24 percent of the variance in franchisee satisfaction. The F-ratio in the ANOVA table tests whether the overall regression model is a good fit for the data. The above table shows that the F-ratio is 17.609 and its associated significance level is small ( $P < 0.01$ ). The table shows that the independent variables statistically significantly predict the franchisee satisfaction,  $F(6,335) = 17.609$ ,  $p < .0005$ , indicate that the regression model is a good fit for the data.

### Estimated Model Coefficients

Unstandardized coefficients indicate how much the dependent variable varies with an independent variable when all other independent variables are held constant. The above coefficients table indicates that, the unstandardized coefficient,  $B_1$ , for Brand is equal to 0.182. For the unstandardized coefficient for the 'Brand' variable, the t value ( $t = 3.124$ ) and the significance level ( $p < .05$ ) indicate that the variable Brand is statistically significant. This clearly indicates that there is a positive correlation between the Brand and the franchisee satisfaction. Hence the **hypothesis 1 (H1)** that 'Brand value of the franchisee relates significantly and positively to the franchisee's satisfaction' **is accepted**. The unstandardized coefficient,  $B_1$ , for Training is equal to 0.096. For the unstandardized coefficient for the 'Training' variable, the t value ( $t = 1.364$ ) and the significance level ( $p > .05$ ) indicate that the variable Training is not statistically significant. Hence the **hypothesis 2 (H2)** that 'Training and Knowledge Transfer relates significantly and positively to the franchisee's satisfaction' **is rejected**. The unstandardized coefficient,  $B_1$ , for Support is equal to 0.074. The unstandardized coefficient for the 'Support' variable, the t value ( $t = 1.774$ ) and the significance level ( $p < .05$ ) indicate that the variable Support is statistically significant. This clearly indicates that there is a positive correlation between the Support and the franchisee satisfaction. Hence the **hypothesis 3 (H3)** that 'The operational support services relates significantly and positively to the franchisee's satisfaction' **is accepted**. The unstandardized coefficient,  $B_1$ , for Communication is equal to 0.159. The unstandardized coefficient for the 'Communication' variable, the t value ( $t = 2.688$ ) and the significance level ( $p < .05$ ) indicate that the variable Communication is statistically significant. This clearly indicates that there is a positive correlation between the Communication and the franchisee satisfaction. Hence the **hypothesis 4 (H4)** that 'Communication & feedback relates significantly and positively to the franchisee's satisfaction' **is accepted**. The unstandardized coefficient,  $B_1$ , for Trust is equal to 0.180. The unstandardized coefficient for the 'Trust' variable, the t value ( $t = 3.046$ ) and the significance level ( $p < .05$ ) indicate that the variable Trust is statistically significant. This clearly indicates that there is a positive correlation between the Trust and the franchisee satisfaction. Hence the **hypothesis 5 (H5)** that 'Contractual integrity & trust relates significantly and positively to the franchisee's satisfaction' **is accepted**. The unstandardized coefficient,  $B_1$ , for Return is equal to 0.191. The unstandardized coefficient for the 'Return' variable, the t value ( $t = 4.083$ ) and the significance level ( $p < .05$ ) indicate that the variable Return is statistically significant. This clearly indicates that there is a positive correlation between the Return and the franchisee satisfaction. Hence the **hypothesis 6 (H6)** that 'Financial returns that the franchisor helps generate from the business, relates significantly and positively to the franchisee's satisfaction' **is accepted**.

### Conclusions & Suggestions

Franchisee satisfaction is crucial for the success of the franchise system. The study has identified six key franchisor inputs that can contribute for their satisfaction: Brand Value of the Franchise, Training & Knowledge Transfer, Operational Support, Communication & Feedback, Contractual Integrity & Trust and Financial Returns.

Franchisees who participated in the survey have shown a lot of satisfaction with their current franchisor. But some areas of dissatisfaction were observed, which need to be worked upon for the healthy growth of the relationship and the success of franchising as a business model. The brand value had a very strong positive correlation with franchisee satisfaction. Franchisees were generally positive about franchise brand. It is suggested that franchisors continue to actively support the brand, as franchisees have high levels of pride in the franchise brand with which they are associated. Franchisors should come up with more product innovations and promote the brand even more aggressively. Financial returns from the franchise business also had a very strong positive correlation with satisfaction. It has been observed that the franchisees' expectations of the financial return from the franchise may be unrealistic. Franchisors have to educate their franchisees about the value they receive and also to make the expectations more realistic. Communication also showed a strong positive correlation with satisfaction. Communication between franchisees and the franchisor is vital to keep the relationship in good spirit. Franchisors have to keep all their channel of communication open, frequent and useful with regular interactions. The franchisors should give regular feedback about their franchisees' performance. Communication should remain a focus of all franchisor activities. Contractual integrity and trust factor also has a very substantial impact on the satisfaction. Franchisors should ensure that the initial and ongoing support services that are provided should be given prime importance for

strengthening the franchise system. Majority of the franchisees were not happy with the local marketing and promotion activities carried by their franchisor to attract and retain customers. Franchisors have to support their brand with more advertising and promotional activities, both at the national and local level. Surprisingly, the data revealed no significant impact of training on franchisee satisfaction. Nevertheless, franchisors should also train their franchisees in the business process and ensure complete knowledge transfer, so as to equip them with the required knowledge, skills and attitudes in performing their business better.

### Limitations

1. A limitation in this study is that the validity of the data collected is a consequence of the respondents' understanding of the questions and willingness to answer them honestly.
2. The scope of the study is limited to the city of Bangalore and to retail industry.
3. This study was a cross-sectional study.

### Further Research

1. Similar study may also be conducted in other parts of the country and other industries.
2. The whole study has been designed around the franchisee as the epicenter. Evaluation of franchisor's perspective is also necessary in order to have a complete picture of the franchisor-franchisee relationship.

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