Available online at www.sciencedirect.com
ScienceDirect
Procedia - Social and Behavioral Sciences 122 (2014) 515 – 519
Procedia
Social and Behavioral Sciences

2nd World Conference on Design, Arts and Education DAE-2013

Determining pros and cons of franchising by using swot analysis

Menekse Salar [a] *, Orkide Salar [b]

[a] *PhD student in Industrial and Systems Engineering, Auburn University, Auburn, Alabama, 36849, United States of America*
[b] *Student in Civil Engineering, Bogazici University, Bebek, Istanbul, 34342, Turkey*

Abstract

This report is an attempt to compare the advantages and disadvantages of franchising which is one of the most known business model. To start with, the swot analysis is defined. Then, the advantages of Franchising are explained. These are brand recognition, low risk to failure, easy set up, ready customer portfolio and easy to find financial support. In the third part, the disadvantages of franchising are explained that are strict rules, dependency and high cost. Finally, in the last part, the advantages over disadvantages of franchising are analyzed and it is concluded that the franchising is more advantageous.

Keywords: Franchising, swot analysis;

1. Introduction

Nowadays, business models are increasing. One of the most known business model is franchising. When there is an owner of national or regional chain company and a person who wants to operate one of their companies, they make a contract. This contract enables person to operate one of their outlets. These outlets must be same with the original company; using same furniture, equipment, having same service and taste. These contracts show differences according to the owners, it can be based on initial payment or a percentage of gross sales. To sign a contract in order to be a part of a known business is called as franchising. Franchising has been providing business opportunities for over 150 years.

"According to the International Franchise Association (IFA), the industry's largest trade groups, almost 4 percent of all small businesses are franchises and the industry accounts for 40 percent of all retail sales in the country" (Bohi, 2010, p.16). It is believed that franchising comes from the mid 1800s. The earliest franchising was done by Singer Sewing Machine in the United States in 1851. Coca-Cola started to franchise in 1899, then, oil refineries and auto manufacturers began to franchise to distribute their products in different parts of the country. After that, America wants to improve their restaurant chains and Kentucky Fried Chicken started in 1930, Dunkin Donuts started in 1950 and McDonalds which is the most successful franchise in the world started to franchise in 1955.

This paper has been written to determine the pros and cons of franchising by the help of SWOT analysis and compare them. This paper is divided into seven sections. The next section explains the literature review. The third section explains the SWOT analysis. The advantages are explained in section four. The disadvantages explained in section five. In section six, the advantages over disadvantages are explained. Finally, the conclusion is provided.

* Corresponding Author: Menekse Salar. Tel.: +1-678-907-2896
E-mail address: mzs0053@tigermail.auburn.edu, salarmenekse@hotmail.com

doi:10.1016/j.sbspro.2014.01.1385

2. Literature review

According to Franchise Facts 2011, today, franchising is big business, and there are over 3,000 franchise systems in the USA. Franchising is an entrepreneurial activity that plays a crucial role in the creation of new jobs and economic development (Falbe et al, 1998). In addition to this, Franchising is a prominent part of the economy and a central phenomenon in entrepreneurship. Practitioners often recommend franchising as a method that entrepreneurs can use to assemble resources to create large chains rapidly. (Michael, S. C, 2003). In addition to this, it is a method recommended especially for entrepreneurs who can create large chains with franchising. In return, the franchisee pays an up-front fee and ongoing royalties to the chain operator (Combs et al, 2004).

A franchise is an agreement granting a person or group of individuals (the franchisee) the right to market a product or service using the brand name and operating methods of a business (the franchisor) in exchange for a fee (typically an up-front fee plus recurring royalties on sales) (Knott, A. M., Corredoira, R., Kimberly, J., 2008). Moreover, Franchising has literally reshaped the retail landscape since its infancy in the 1950s. By most estimates, franchising now accounts for $1 trillion in annual retail sales from approximately 320,000 businesses in 75 industries and employs more than 8 million people (Dant, R. J., Kaufmann, P.J., 2003).

In franchising, a chain operator–entrepreneur collaborates with a franchisee–entrepreneur to create economic value. Specifically, the franchisee obtains from the chain operator the right to market goods or services under its brand name and to use its business practices **(**Barthelemy, J, 2011). In the global market, franchising adds value by enhancing the understandings of local culture, customs, and values (Contractor F. J., and Kundu, S. K., 1998).

According to IFA Educational Foundation, 2005, franchise businesses are important to the overall economy, generating over $1 trillion in annual sales—representing 17% of the U.S. Gross Domestic Product—and averaging 300 new franchise start-ups each year. There are approximately 901,093 franchisees and they are employing approximately 18 million people, in turn generating an economic output of over $2.1 trillion which equals about 40.9% of the U.S. retailing sector (Dant, R.P., Grünhagen, M. and Windsperger, J., 2011).

3. Swot analysis

SWOT analysis has its origins in the 1960s (Learned et al., 1965). In addition to this, The key tool used presently in planning the national sustainable development is Strengths, Weaknesses, Opportunities and Threat (SWOT) analysis, which originates from the business management literature and was adopted in the 1980s by public administration across such areas as regional development and municipal planning (Markovska, N., Taseska, V., and Pop-Jordanov, J., 2009). SWOT analysis is an important decision-making support tool, and is commonly used to systematically analyze the strategic situations and identify the level of organizations from their internal and external environments (Gao, C-Y., and Peng, D-H., 2011). Having identified these factors strategies are developed which may build on the strengths, eliminate the weaknesses, exploit the opportunities or counter the threats (Dyson, R. G., 2004).

This analysis helps organizations, projects or even individual about systematic thinking and comprehensive diagnosis of factors. In addition to this, the organizations can identify their positive and negative factors and then develop and adopt a strategy resulting in a good fit these factors (Gao, C-Y., and Peng, D-H., 2011). The strengths and weaknesses are identified by an internal appraisal of the organization and the opportunities and threats by an external appraisal (Dyson, R. G., 2004). The last version of SWOT analysis is developed by Dealtry in 1992. According to him, the steps are built on strengths, eliminate weaknesses, exploit opportunities and mitigate the effect of threats. The SWOT analysis is used to identify the advantages, disadvantages, threats and opportunities of franchising. This is shown in table 1 below.

Table 1. SWOT analysis of franchising

Strengths	Weaknesses
○ Brand Recognition ○ Lower Risks for Failure ○ Easy Setup ○ Ready Customer Portfolio ○ Easy to Find Financial Support	○ High Cost - Initial Cost - Ongoing Costs ○ Dependency ○ Strict Rules
Opportunities	**Threats**
○ Entrepreneurs have chance to become their own boss ○ It offers some market opportunities like discovery and exploitation (Davies, M. A. P., 2011)	○ Continuing growth of existing franchised competitors ○ Other new franchise competitors entering market place ○ The decline of branding in market ○ The publication of New Business Models

4. Advantages

Nowadays, franchising is the most favorite business model because of its satisfactory circumstances to the franchisors. According to Bohi, “Franchising have some benefits advertising, training, networking, technical support, and other business support services that many one-man operations cannot afford, or simply do not have the expertise in” (2010, p.15). The best known advantages are;

4.1. Brand Recognition

Branding is a very powerful component in business. According to the online dictionary, brand recognition is a marketing concept that shows customers’ knowledge of a brand existence. To open a franchise offers a brand which has already established and people are familiar with. A national franchise consulting and marketing firm, works with franchisers to help them sell to prospective franchisees and to refine their brand (Bohi, 2010).

4.2. Lower Risks for Failure

Entering in an industry, the most important thing for entrepreneurs is the lower risk for failure. There is a big difference in failure rates for entering in a new market and entering in a known market. According to Cavaliere and Swerdlow, the Department of Commerce statistics further reveal that franchisor-franchisee failure rates are substantially below the failure rates for new business in general (1988, p.11).

4.3. Easy Setup

One of the most challenging things for entrepreneurs about entering in a new market is how to build. Franchising eliminate this problem because they often provide easy setup for franchisors. According to Cavaliere and Swerdlow, “the franchisee gets its entire business format from its franchisor; this includes marketing strategy and plan, operating manuals and standards, quality control and continuing two-way communications”(1988, p. 11).

4.4. Ready Customer Portfolio

In franchising, the most important affect is to comfort of knowing which means customers know that they can find the same quality and same service of the product or service. Most of the franchise business’ customers are known as loyal customers. Loyal customer is the most valuable capital for businesses. According to Robert Bosch, “I prefer losing money instead of losing customer confidence”.

4.5. Easy to Find Financial Support

Banks and similar institutions provides convenience to the franchises about getting funding and financing because it is known that there is a low failure risk rate in franchising. Banks will prefer to finance a known business model than a new business.

5. Disadvantages

Even though franchising has some advantages, buying a franchise has some major drawbacks faced by a franchisor. These are;

5.1. High Cost

Buying a franchise has some costs such as start-up expenses, utilities, rent, franchising fees, employees and taxes. These costs divide into initial and on-going costs.

5.1.1. Initial Cost

Initial cost means non-refundable initial franchise fee. Franchisees pay the franchisor a one-time fee upon joining the system and subsequently pay a percentage of their gross sales as royalties (Coughlan et al., 2003). In addition to this, the Franchise Disclosure Document (FDD) requires that the document be presented to potential franchisees, 10 days before the franchisors receive the first payment from the franchisee (Bohi, 2010).

5.1.2. Ongoing Costs

Franchisees have to some expenses except initial payment like rent royalties, advertising fees, equipment maintenance, employees, insurance and inventory, a percentage of the gross sales to the franchisor. The percentage of gross sales are generally between 3 o 10 percent of the gross sales and this payments like rent which means fixed and made by each month.

5.2. Dependency

Another problem is dependency which means franchisees has own business but franchisor has their own business independently. According to Cavaliere and Swerdlow, Franchisors obtain money from franchisees, some of which translates into profits from the franchising activity itself, and also indirectly obtain expansion capital which is at the sole liability of the franchisees" (1988, p.13). Franchisors want to follow franchisees because franchisees want to convert their investments to the profit and franchisor wants to be a part of the profit.

5.3. Strict Rules

The other problem is strict rules, it means franchisees have an own business but it governed by franchisor. Franchisor gives a long list of guidelines to the franchisees and franchisees have to follow these rules. Franchisees have to serve the same service to the customers and use same materials and equipments. According to Cavaliere and Swerdlow, "most franchise agreements provide the franchisor with extensive controls in this regard and are devoid of impediments to franchisor discretion, such as binding arbitration" (1988, p. 13).

6. Advantages Over Disadvantages

Entering to a new business or to a known business has both some difficulties and some easiness. The most important thing is to select the most profitable way. First of all, franchising offers a known brand name which is very important for customers and buyers because entering in a known business has a lower failure risk rate. Franchising also provides people easy setup which is also one of the most thinkable thing while entering in a business. Entrepreneurs who don't have enough capital for buying a franchise, it is easy to find financial support for franchising. Entering a business has many important factors but buying franchising change these factors into opportunities. It is not means that it doesn't have any disadvantages. The known disadvantages are high cost which people can easily find financial support, dependency which shouldn't be known as bad because when people depends on somebody or something, it means they don't share the risk alone. The other disadvantage is strict rules. People sometimes get nervous about rules but without rules there shouldn't be any arrangement and companies shouldn't grow like today.

7. Conclusion

Based on a wide research, franchising offers brand recognition, lower risk rate for failure, easy to find financial support and easy set up in a business. On the other hand, franchising has also some difficulties which are high costs, strict rules and dependency. When these are taken into consideration, Franchising becomes more advantageous.

References

Andrews, K. R. 1965, The Concept of Corporate Strategy, Dow Jones-Irwin, Homewood, II
Barca, M. 2005. The Evolution of Strategic Management Thought: A Story About Emergence of a Scientific Discipline, *Yonetim Arastirmalari Dergisi*, 5 (1), pp. 7-38
Barthélemy, J. (2011). Agency and Institutional Influences on Franchising Decisions. *Journal of Business Venturing*
Bohi, H. (2010). Time To Buy A Franchise. *Alaska Business Monthly*
Cavaliere, F.J. & Swerdlow, M.R. (1988). "Why Franchise?". *Business Forum/Summer*
Chadler, A. 1962. Strategy and Structure: Chapters in the History of the American Industrial Enterprise, *MIT Pres Cambridge*, MA, pp. 52-393
Combs et al; Combs, J., Michale, G. and Castrogiovani, G., 2004. Franchising: A review and Avenues to Greater Theoretical Diversity*, Journal of Management*, Volume 30, pp. 907-931
Combs, J. G., KetchenJr., D. J., Hoover, V. L., A Strategic Groups Approach to the Franchising-performance Relationship, *Journal of Business Venturing*, Volume 19, Issue 6, 2004, pp. 887-897.
Coughlan et al; Coughlan, A., Anderson, E., Stern, L. Stern, E-A, Marketing Channels, *Prentice Hal*l, 2003
Dant, R.P., Grünhagen, M. and Windsperger, J. (2011) Franchising Research Frontiers fort he Twenty-First Century, *Journal of Retailing*, Volume 87, Issue 3, pp. 253-268
Dant, R. P. and Kaufmann, P. J. (2003). Structural and Strategic Dynamics In Franchising. *Journal of Retailing.*
David, F.R., 2007. Strategic Management Concepts and Cases, *11th ed. Prentice Hall*, New York
Dealtry, T. R., Dynamic Swot analysis: developer's guide, *Dynamic Swot Associates*, Birmingham, 1992.
Drucker, P. 1946. Concepts of the Corporations, *The John Day Company*, New York
Dyson, R-G, Strategic Development and Swot Analysis at the University of Warwick, *European Journal of Operational Research*, Volume 152, Issue 3, 2004, pp. 631-640
Falbe et al; Falbe, C., Dandrifge, T. and Kumar, A. (1988) The Effect of Organizational Context on Entrepreneurial Strategies in Franchising. *Journal of Business Venturing,* 14, pp. 125–140
Gao, C-Y, and Peng, D-H, Consolidating Swot Analysis with Nonhomegeneous Uncertain Preference Information, *Knowledge-Based Systems*, Volume 24, Issue 6, 2011, pp. 796-808
International Franchise Association (IFA) – www.franchising.org
Koh, Y., Lee, S., Boo, S., Does Franchising Help Restaurant Firm Value?, *International Journal of Hospitability Management*, Volume 28, Issue 2, 2009, pp. 289-296
Knott, A. M., Corredoira, R., Kimberly, J., Improving Consistency and Quality of Service Delivery: Implications for the Addiction Treatment Field, *Journal of Substance Abuse Treatment*, Volume 35, Issue 2, 2008, pp. 99-108
Learned et al; Learned, E. P., Christensen, C. R., Andrews, K. R. and Guth, W., 1965. Business Policy: Notes for Analysis, Dow Jones-Irwin, Homewood,III
Markovska, N., Taseska, V., and Pop-Jordanov, J., Swot Analyses of the National Energy Sector for Sustainable Energy Development, *Energy*, Volume 34, Issue 6, 2009, pp. 752-756
Michael, S. C. (2003). First Mover Advantage Through Franchising. *Journal of Business Venturing*
Nair, S. K., Tikoo, S., and Liu, S., Valuing Exclusively from Encroachment in Franchising, *Journal of Retailing*, Volume 85, Issue 2, 2009, pp 206-210
Online Etymology Dictionary – www.etymonline.com
Selznick, P. 1957. Leadership in Administration: A Sociological Interpretation, Harper & Row, New York
Sevkil, M., Oztekin, A.., Uysal, O., Torlak, G., Turkyilmaz, A., and Delen, D., 2012. Development of a Fuzzy ANP Based SWOT Analysis fort he Airline Industry in Turkey, *Expert Systems with Applications*, Volume 39, Issue 1, pp. 14-24