UNDERSTANDING THE RISKS OF INTERNATIONAL FRANCHISING

Ana-Maria DINU

Abstract: *Franchising a business represents considerable opportunity for one entrepreneur but like all businesses there are risks associated with franchising that must be considered wisely against the probable upside. Some business owners who wish to start a franchise should be concerned about the risks and costs involved in this process. In franchising operations are various variables and risks that may affect the business, such as the economic, political and demographic environment, market conditions and competition. Therefore, the main problem is if the level of risk is acceptable and manageable. If franchising is cautiously understood by both partners and the franchise system is accurately established and managed according to respectable quality franchise practice, then it can considerably decrease risk in business.*
Keywords: *business, franchise, risk, international, understand risks, risk share.*

Introduction

Franchising is known as one of the most modern and used techniques in the international economic relations and ones say that franchise is the safest method of investment for those who want to succeed in business without risk. Also this type of business is seen as a specialized form of licensing where not only the franchisor sells to independent franchisees the right to use an intangible property but also provides ongoing operational support to the affair.

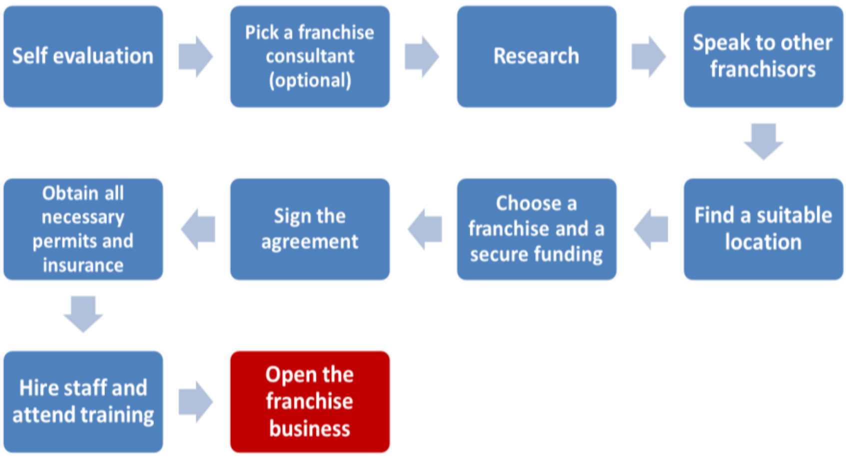
Franchising can be defined as the granting of a license by one person, named in the literature as the *franchisor* to another, named the *franchisee*, which allows the franchisee to possess and operate their own business under the brand, systems and established business model of the franchisor.

Furthermore, the franchise is the method that the investor uses to reduce the risks of a new business, for example the risks caused by lack of information and high costs. Buying a franchise package provides all the information required to start the work. Also, the franchisee can benefit from training and mentoring that can help reduce the risk of failure.

Therefore, a franchise is a legal contract authorizing a business to provide a product, name, trademark, or idea to an independent business possessor. Each partner of a franchise contract offers legal rights in order to obtain others. The franchisor raises its number of offices and gains extra income and the franchisee opens an reputable business with great potential for success. Franchising offers persons a chance to manage, own, and direct their own business without having to take all the associated risks. This aspect has allowed a lot of people to open businesses who might never have done on their own.

The principle of this operation is quite simple - rather than evolving company-owned outlets, instead some businesses develop by granting a franchise to other parties to sell their products or services. Besides using to a famous brand name, buying a franchise offers many other advantages that are not available to the entrepreneur starting a business from the beginning. Maybe the most noteworthy is that he gets a confirmed system of operation and training in how to use it. One of the most important franchise advantage to a franchise owner is that it lessens the risk of business failure.

The literature presents many methods to understand the franchising process and many steps to begin one. Beneath is shows a model of the most important steps to develop a franchise:



Source: franchisebusiness.com
Figure 1. The steps of franchising

Evidently there are risks to having a franchise, as there are in owning any business. Although franchising is considered as a safer method of doing business, it does not mean that it is risk free. The threats must be evaluated in contradiction with the benefits and see what's most important as a business owner. Many franchises have failed in the past and many will fail in the future. There are a lot of motives why they have been unsuccessful and this is the reason why it is vital to start doing research when interested to buy a franchise business to find the right franchise and to help spotting an unprofitable franchise from a profitable franchise. A lot of persons are concerned in exploring the opportunities of a franchise ownership because of the idea that it is a lot less risky to invest in a franchise business as opposed to an independent business. Regardless who owns a franchise, both partners share the risks and the responsibilities, although not every time equally. Since both associates have a financial investment at stake, the risk can be considerable.

Obviously there are many risks that arise when vending a franchise. Some of these are commercial, such as the risk of finding an unprofitable franchisee, the risk of spending money and time on a prospect that does not progress, the risk of miscalculating the potential for a franchise in a location or the risk of not enticing the best caliber of franchisee. These risks are addressed by regularly adopting well researched and suitable strategies and techniques for franchisee recruitment and selection.

The risks of franchising can be presented into four wide categories:

- reputational risks,
- financial risks,
- risks to brand integrity,
- legal risks.

In some cases, it may be less risky to be the proprietor of a franchise business, but there are things that must line up correctly, such as:

- the eventual franchise owner's abilities line up perfectly with the role they will be taking on as a franchisee;
- the eventual franchise owner's financial state leaves lots of room for ramp-up time;
- the franchise idea itself won't become rapidly a trend;
- the eventual franchisee's geographical region can support effortlessly the franchise idea.

In the next rows are shown some of the most important risks for franchisee:

The first risk for the franchisee can be the rules from the franchisor, such as the restriction to do the marketing, the inventory or in changing the program hours. This is one of the reasons why the contract between the parties must be read through all the rules and regulations.

A second risk is the reduced profit because the franchisers take a considerable amount of the franchisee incomes. It is recommended to do a heavy research on how much money are expected to make and if the investment is worth.

Another risk for the franchisee is the long term contract. In the current economic climate is not a good idea to sign an agreement for several years.

The last and the most important risk is the success of the franchise, which can be a big risk if the franchisee depends on the franchise support. Location, service and the economy all play into whether the franchise will succeed, and no one can predict the outcome of any of these.

Methods for risk sharing

Many franchisees consider that they are facing added risks in today's economic environment but still want to buy a franchise. Franchisors can share the risk and in the process can entice more new franchisees.

A first step can be offering start up supporting for the early franchise fee and other services by using a promissory note to protect the financing and offer a repayment plan and by that the franchisee can be able to invest capital. Another way is starting new locations under a joint venture program and the franchisee can possess fewer than 50% equity with a program to be able to buy out the franchisor equity. Also, the franchisor can start a first-rate corporate owned location with the plan to sell them as a franchise, and the share of the purchase price to be financed. This technique can also be used to enter new markets, and the franchisor obtains a broad and complete understanding of what is necessary to do to succeed in that specific market. Besides, the providing of aggressive sales programs for new franchisees allows them to get discounts. It is a way to recompense franchisees for attaining goals that bring their franchise to an upper sales level much faster. It is also possible to participate in a exchange franchise program, if the franchise concept is capable of this approach.

Conclusions

Like any other business decision, franchising contains a fair share of risks and rewards. Franchising is considered an action of risk minimization, thus less risky than engaging in a new venture start-up company. For the franchisor, it offers opportunities for expansion and large-scale economies of scales. For the franchisee, starting a franchise brings a well-known reputation and reduced risks. The most important advantage of franchising for the business owner is risk reduction. Buying a franchise offers franchisees the chance to form a business on their own theoretically, but not necessarily on their own.

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NOTE ON AUTHORS:

ANA-MARIA DINU is PhD Lecturer at the Faculty of International Business and Economics from the Christian University of “Dimitrie Cantemir”, Bucharest, Romania. E-mail adress: anadinu13@yahoo.com