

INSTRUMENTS OF FINANCING THE FRANCHISE PURCHASE

INSTRUMENTI ZA KUPNJU FRANŠIZE

BOROVAC ZEKAN, Senka & BRANKO, Soric

Abstract: *Franchising in economically developed countries has been proved as successful way of starting business. The research in developed western countries have shown that the probability of survival of entrepreneurial ventures is greater if it is part of some franchise chain. According to estimate of Croatian franchise association, around 15000 people are already involved in some form of franchising business in Croatia. It is assumed that Croatian accession to the European Union will result in growing interest in franchising. This article provides an answer to the question whether the Croatian banks are prepared to facilitate the entry of entrepreneurs into the business world. Do the Croatian Banks have prepared the financial instruments intended for entrepreneurs who want to enter the world of business by buying a franchise?*

Key words: *franchise, starting business, financial instruments, banks*

Sažetak: *Franšizno poslovanje u ekonomski razvijenim zemljama se pokazalo kao uspješan način ulaska u svijet poduzetništva. Istraživanja u razvijenim zapadnim zemljama pokazala su kako je vjerojatnost preživljavanja poduzetničkih pothvata veća ukoliko su oni dio nekog od franšiznih lanaca. Prema procjeni Hrvatskog franšiznog udruženja, oko 15000 ljudi u Hrvatskoj je uključeno u neki oblik franšiznog poslovanja. Pretpostavlja se kako će pristupanje Hrvatske Europskoj uniji rezultirati većim interesom za franšizno poslovanje. Ovaj članak daje odgovor na pitanje jesu li hrvatske banke pripremljene kako bi olakšale ulazak poduzetnika u poslovni svijet kupnjom franšize. Imaju li hrvatske banke financijske instrumente namijenjene isključivo poduzetnicima koji žele ući u svijet poduzetništva kupnjom franšize?*

Ključne riječi: *franšiza, osnivanje tvrtke, financijski instrumenti, banke*



Authors' data: Senka, **Borovac Zekan**, Assistant Lecturer, University Department for Professional Studies in Split, Croatia, Livanjska 5, e-mail: sborovac@oss.unist.hr; Brako **Soric**, Senior lecturer, University Department for Professional Studies in Split, Croatia, Livanjska 5, e-mail: bsoric@oss.unist.hr

1. Introduction

Franchise is a system whereby independent entrepreneurs work together in a contractual network. The franchiser creates a franchise concept based on original service or product. In order to develop it commercially, he or she contracts with other entrepreneurs, the franchisees, who commercialize the franchiser's service or product. Hence even if the parties are juridically independent they work hand in hand which is formalized through the franchise contract.[1] Franchising in economically developed countries has been proved as successful way of doing business. Franchising is a growth business model that significantly reduces the uncertainty in the riskiest stages of growth: starting a business and a stage of rapid growth. But, its application demands development and education of institutions which should support realization of these partnerships and those are banks, lawyers and institutions for entrepreneurship support whose goal is to educate and inform entrepreneurs. The aim of this paper is to examine the preparedness of Croatian banks and availability of their financial instruments for entering the world of business by buying a franchise.

2. Literature review

Franchising holds many different meanings. Some researchers define a franchise as a contractual privilege granted by an individual or company (owner) to another individual or company, while others view franchising as a license from the owner (franchisor) of a trade or service mark permitting the user (franchisee) to market a product or service under that name in accordance with the franchisor's system. Some suggest that franchising is a distribution method used by businesses for growth and expansion, or a method of raising capital by and for the franchisor. There seem to be no consensual definition even though most of these definitions are highly correlated. There are two franchise models[2]:

- 1) *product distribution franchise* where the franchise buyer buys the distribution right for a specific territory. What the buyer is paying for in this case is the brand. If this is the model the entrepreneur is considering, he/she has to be sure in the strength and the market value of that particular brand in his/her territory. The well known name in Italy or Spain can be completely unknown to the final consumers in Croatia.
- 2) *business format franchise* is the model where the buyer in addition to the right to use somebody's brand (trade mark) also buys the business model as the recipe of how to do business in this particular business branch. When buying this kind of franchise it is not necessary that the name the entrepreneur is buying is well known at his/her market. If the business model that is the part of the franchise package is innovative and creates the competitive advantage on his/her market, they don't have to worry about the recognition of the brand.

The work of Nerilee Hing (1993, 1995)[3] demonstrates clearly the importance of initial steps toward the choice of a franchise. The table below shows that entrepreneurs have listed, among other things, the reasons for entering a franchise business: low development costs (compared to independent business) and quick start.

| Authors | Reasons for choosing franchise |
|----------------------|--|
| HUNT (1977) | Brand (known trade name) Assistance before and after opening of the business |
| KNIGHT (1986) | Known trade name More independence than salaried employment Greater job satisfaction Less risky than independent business More profitable than independent operation Quicker business development |
| PETERSON&DANT (1990) | Training Independence (compared to salaried work) Established name Low development costs (compared to independent business) High profitability Low operational costs (compared to independent business) Less of a commitment (than independent business) |
| WITHANE (1991) | Proven business format Less risky (than independent business) Goodwill (possibility to make profit) Start-up support (when starting the business) On-going support (when running the business) Quick start (because of proven business system) Gain some experience (in management or in the sector) Personal liking More money (than salaried work or than independent business) Fad |

Source: Kaufmann, Patrick J. & Stanworth, John (1995) *The Decision to Purchase a Franchise: A Study of Prospective Franchisees*, Journal of Small Business Management, October, 22-32.

Table 1. *List of the reasons for choosing franchise drawn from the franchise literature*

3. The advantages of entering a business franchising

Franchise offers many advantages for those who want to start their own business. Franchisees can enjoy many of the benefits of self-employment with less risk. Successful franchise operations have a much lower failure rate than completely new businesses. Buying an existing franchise is becoming a sensible and safer option as a way into starting a business. It has many advantages such as:

- the ability to generate profits at an earlier stage
- guaranteed income from day one
- not having to go through the initial set-up, which is the riskiest time
- an established customer base and public acceptance
- easier to make financial projections as you have all the past records
- starting with trained/qualified staff
- starting with established suppliers

Some researches showed that in the developed western countries large number of companies works as franchises and also that the odds of franchise company being still alive after five years are much greater if you entered the business as a part of some franchise network than if you started independent new business[4].

4. Franchise in Croatia

In Croatia, the franchise becomes more developed, both among the entrepreneurs who start buying a franchise business, and among mature businesses that use franchising as a growth model and build their own franchise network. According to estimate of Croatian franchise association, around 15 000 people are already involved in some form of franchising business in Croatia.

The EU already has about 10,000 franchise systems. Eighty percent of them are the original franchise from the EU. Among the 500 top European franchises are only two franchise systems in Central and Eastern Europe - Fornetti from Hungary with 6464 and Bata in the Czech Republic with 5000 franchise locations in the world.[5] Croatia has only 25 Croatian franchise, while, for example, in Hungary 240 out of 340 are local franchises, and in Slovenia 52 are local franchises of a total of 107 franchise networks. According to the Croatian Franchise Association - there are currently attended by 170 franchise networks that indirectly employ about 16,500 people. A small share of domestic (Croatian) franchise network in relation to the total number of franchises in Croatia indicates the existence of barriers to their development.

5. Research methodology

The empirical section of this paper comprised a primary research, which was conducted in Croatian banks during the months of May and June 2012. The sample consisted of four leading banks operating in Split that were selected based on their financial statements (table 2.).

| Bank | Loans to clients (31.3.2010) | Quarterly growth/decline (%) | Provisions for losses | Annual growth/decline (%) | Net profit | Annual growth/decline (%) |
|------------|------------------------------|------------------------------|-----------------------|---------------------------|------------|---------------------------|
| ZABA | 62.630 | 3 | 190,68 | 252,5 | 277,91 | -20,6 |
| PBZ | 42.209 | 0 | 74,6 | 10,4 | 183,03 | 2,1 |
| ERSTE bank | 32.421 | 1 | 127,88 | 122,4 | 117,04 | -32,1 |
| RBA | 23.710 | -2 | 50,02 | -62,5 | 115,36 | -5,6 |

Source: *Financial statements of banks on ZSE*

Table 2. The results of the leading banks in the first quarter of 2010. (in mil. KN)

Objectives were derived from a careful understanding of the problem under study. The authors have select the top executive managers as their target audience based on the perspective they were interested in obtaining since they could best provide them with the information they needed. An in-depth interview was then scheduled and conducted by the authors with managers of the banks. The interviewees were all managers occupying top managerial positions in their respective organizations. The in-depth interview comprised 8 questions, most of which could not be asked in a multiple-choice format, because of the need to probe beyond superficial answers to reveal reasoning, and therefore required the skills of an interviewer.

6. Empirical research

All franchises require the entrepreneur to pay an upfront franchise fee. In addition to the franchise fee, the entrepreneur needs cash on hand for build-out costs and marketing, and enough money to support themselves and their family for the first year or two. They will most likely need to find financing or a franchise loan to cover the costs of opening the franchise. Financing a franchise should be easier than financing an independent business. Franchisees generally have an easier time securing bank loans than their independent business owner counterparts, because they have behind them the established trademark and marketplace experience of their franchisor.[6] Is that the case in Croatia? Empirical study was conducted on a sample of four leading banks in Croatia. The criteria for bank's selection were the financial annual report of ZSE*. The questions asked in-depth interviews were related to advantages and disadvantages of financing entrepreneurs which are starting business with buying of franchise.

The survey highlighted the ignorance of the concept of the franchise in Croatia and lack of interest of financial institutions investment and financial assistance to this sector, which accounts for over 50% in developed countries and shows high statistical level of performance in relation to self-employment. None of the bank has no instruments intended solely financing a franchise purchase, nor they think about it, unlike western countries banks who have departments for franchise business within they are working for the franchise brokers. On the contrary the Croatian banks even do not recognize the franchise business as a safer way of entering the business.

7. Research limitations

The study can be considered as preliminary. It is certainly necessary to conduct a research which would include all banks at the Croatian market, but the researchers' assumption is that the research results would remain the same.

8. Author's remark

Given the limited number of pages given by the conference organizing committee, details of in-depth interviews are available upon request. Here we gave only a summary of the most important parts in-depth interviews.

9. Conclusion

The popularity of the franchise general acceptance is demonstrated by the fact that in the world every six and a half minutes is opened a new franchise business. However, the Croatian market, as regards the franchise, still is in its infancy, and one of the main reasons for this is lack of knowledge of the local people concerning the franchise concept and how it is used. This survey showed that banks do not want to fund a franchise fee which is paid to practical "knowledge" and the right to use the brand, because it's intangible assets.

Furthermore, they make no distinction between the newcomers and entrepreneurs entering the business as franchisees, although it is a less risky business. For successful franchising development in Croatia it is necessary to overcome the key obstacle which is a lack of adequate credit programs to finance the purchase of a franchise. Therefore we conclude that the franchise concept application demands development and education of all institutions, primary the banks, which should support realization of franchise partnerships.

10. Reference

[1]Elango, B. & Fried, Vance H. (1997): *Franchising Research: A Literature Review and Synthesis*, Journal of Small Business Management, July, 68-81.

- [2]Hing, Nerilee (1993). *Contributors and Consequences Relating to Franchisee Satisfaction in Australian Restaurant*, Phd Thesis, University of New England-Northern Rivers.
- [3]Hing, Nerilee (1995): *Franchisee Satisfaction: Contributors and Consequences*, Journal of Small Business Management, April, 12-25.
- [4]Kaufmann, Patrick J. & Stanworth, John (1995) *The Decision to Purchase a Franchise: A Study of Prospective Franchisees*, Journal of Small Business Management, October, 22-32.
- [5]http://www2.hgk.hr/komora/hrv/zupkom/Split/hgkcms/prikaz_detaljno.asp?ID=127
- [6]<http://www.suvremena.hr/21178.aspx>
- [7]http://www.cepor.hr/news/fransiza/objava_za_medije.pdf
- [8]<http://www.liderpress.hr/Default.aspx?sid=49912&to=Printable.ascx>
- [9]www.fransiza.hr
- [10]http://www.fransiza.hr/cliping/centar_za%20fransizu_Osjecki_dom_tisak_engl.pdf
- [11]Financial statements of banks on ZSE (14.06.2012)



Photo 012. Wine cellar / Klijet i spremište vina