

THE ROLE OF FRANCHISE IN THE SME SECTOR DEVELOPMENT: CROATIAN EXPERIENCE

ULOGA FRANŠIZE U RAZVOJU MALOG I SREDNJEG PODUZETNIŠTVA: HRVATSKO ISKUSTVO

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Abstract: *Franchise is not often associated with entrepreneurship, but it does represent an entrepreneurial act which involves all aspects of the entrepreneurial process, including idea formulation, opportunity recognition, pre-start planning and market research, as well as it represents a new business creation with all of its benefits for a national or regional economy. The appeal of the reduced risk compared to conventional start-up, while still retaining elements of entrepreneurship, has been a motivating factor for many people and the growth of franchising around the world is likely to continue.*

Key words: *franchise, SME's, economic development, Croatia*

Sažetak: *Franšiza se često ne povezuje s poduzetništvom pa ipak predstavlja poduzetnički pothvat sa svim njegovim procesima, od ideje, planiranja i istraživanja do realizacije. Također donosi sve prednosti gospodarstvu kroz otvaranje novih poslova, povećanja zaposlenosti, itd. S obzirom na prednosti koje franšiza nudi očekuje se njezino daljnje širenje kako u svijetu tako i u Hrvatskoj.*

Ključne riječi: *franšiza, MSP, ekonomski razvoj, Hrvatska*



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1. Introduction

Entrepreneurship is often described as the catalyst and caretaker of the national and regional economies. The various aspects of entrepreneurship's influence on economic development can be found in contemporary literature (Audretsch & Acs, 2003). There is a wide-spread opinion that national or regional economic development is associated with new firms' creation intensity. New firms formation is considered as an important indicator of entrepreneurial activity and key component in economic development and growth, which has been explained by the creation of new capacities into the market and through improvement of the competitiveness of the economy, industry or region (Fritsch & Mueller, 2004). Numerous studies show that new firms have a significant role to play in employment generation (Baptista et al., 2005), innovation (Fritsch & Mueller, 2005), economic growth and reduction of unemployment. In finding new combinations of existing assets, new niches and market needs, entrepreneurs drive efficiency and raise productivity (Balthelt, 2001). Also, for localities that cannot attract outside investment, entrepreneurship is the only economic development strategy at their disposal (Venkataraman, 2004).

One of the entry routes for starting a new firm is a franchise. Even though it is not often associated with entrepreneurship, the franchise does represent an entrepreneurial act which involves all aspects of the entrepreneurial process, including idea formulation, opportunity recognition, pre-start planning and market research, as well as it represents a new business creation with all of its benefits for a national or regional economy. The appeal of the reduced risk compared to conventional start-up, while still retaining elements of entrepreneurship, has been a motivating factor for many people and the growth of franchising around the world is likely to continue.

Considering the positive entrepreneurship's effects on the economic landscape of a nation or region, Croatia has made a strategic priority to build an entrepreneurial climate and strengthen small and medium-sized enterprise (SME) sector in order to achieve more sustainable growth and development. In order to do so, it is useful for policy makers to know how to increase the activity of firm formation rates in regions, i.e. country. Thus, the purpose of this paper is to present and analyze a franchise as an SME development tool which can significantly contribute to the distribution of business in the country, thus contributing to more balanced regional development in Croatia.

2. Franchising as an SME development tool

Mlikotin-Tomić (2000) defines franchising as a package of intellectual ownership which is related to the brand names, models, samples, know-how and other, and which is used in the further sales of products and services to consumers or final users. Franchise occurs when someone develops a business model and then sells the right for doing business (a franchisor) under that model to other entrepreneur (a

franchisee). The franchisee gets the right for the business model for a certain time period and within certain geographic area. Combs et al. (2004) present two main distinctive characteristics of franchising in comparison to other organizational forms: (i) franchise business models are most often developed in industries where services are an important component and there is a need to bring them closer to the end-user; and (ii) franchise agreements commonly determine a unique allocation of responsibilities, decision making rights and profit-sharing models between a centralized principal (franchisor) and decentralized agents (franchisees). According to Spinelli et al. (2004) the components of relational dynamics in franchising are: wealth creation, communications, brand and exit costs. One of the main reasons for becoming involved in franchising is wealth creation. Both the franchisor and franchisee view their involvement in franchising in the context of how the franchise system will help them become wealthy. For some people this is simply an income stream or an accumulation of assets. For others, it includes wanting to be in the industry they are involved with, the product or services they provide, the people they serve, their role in the business and the degree of control in decision making. Franchising is a long-term contractual relationship (between 5 and 20 years) which faces many challenges due to the changes on market and people. Communication, both formal and informal, is at the core of a relationship flexible enough to last over time. It includes trust, understanding and being a team player.

Franchise has important role in securing employment to individuals without higher education or specialized skills. It also enables individuals without experience to enter in business world and secures elderly people possibility of additional earnings. Economic importance of franchise business can be seen also through data which were results of research conducted by U.S. Department of Commerce/Industry and Trade Administration (2005). They showed that franchisee success rate after first year is 97% and start-up entrepreneurs have 62% success rate. After 10 years of business almost 90% franchisees are still in business compared to only 18% of independent entrepreneurs with start-up companies. The economic impacts of franchising are output and job creation, increase in the tax base, economic modernization, balance of payments adjustments, SME and entrepreneurship development, and the acquisition of dynamic capabilities and skills (Alon, 2006). Furthermore, Dwivedy (2002) points out that franchising brings the transfer of technology and business methods, development of SMEs, creation of jobs, and quality goods at a reasonable price.

Franchise is one of the solutions for small and medium size entrepreneurs. Franchise system brings famous brand name, know-how, communication capacity, etc. In general franchise business give small and medium size entrepreneur tools of big company but it leaves his independency and advantages of entrepreneur. On macroeconomic level, development of franchise business enables development of small and medium size entrepreneurship which is recognized as more dynamic and creates employment and has a lower failure level in relation to traditional small entrepreneurs.

Franchise business has two major influences on market: (i) big number of traditional activities is modernized and rationalized (e.g. hotel industry and hairdressers); and (ii) new markets are created and developed (e.g. print shops and fast food). Most of the new markets are created in service sector. Franchise business contributes to the modernization of distribution sector by knowledge transfer (know-how), technology and competence. It contributed to the distribution dynamics through creation of small and medium-size companies and employment. Franchise business service is tool for increasing competition between brands. It also contributes to the customer development and to development of their need so customer can buy new products and services with more information and service. So, customer can have benefits from big company strength but with service and attention from small company.

Franchising is, at its core, an entrepreneurial alliance between two organizations, the franchisor and the franchisee. Franchising clarifies which partner can best perform certain job that is relevant to the end products or service. The key motivation behind franchising is that each partner seeks to create wealth for him or herself by exploiting the opportunity together (Spinelli, et al., 2004).

3. Franchising in Croatia: policy suggestions

The concept of franchising is not unknown in Croatia yet it remains the least used entry route for entrepreneurs. According to the Croatian Franchise Association, there are currently around 120 franchises operating in Croatia of which around 25 are of Croatian origin (e.g. McDonald's, Subway, Fornetti, X-nation, Skandal, Bio&Bio). Franchises in Croatia have over 900 locations, around 16.000 employees and are present in 20 different industries such as trade, hospitality, fast-food restaurants (Kukec, 2006).

Some of the barriers for franchising development in Croatia include following: (i) no legal regulation of franchising; (ii) dearth of infrastructure related to franchising: no banks that will assist franchisors/franchisees, too few educational centers, no franchise consultants who could help potential franchisors in developing their own networks; (iii) lack of knowledge, i.e. information about franchising, thus potential franchisors/franchisees do not know where to go to and who to contact in order to start a franchise; (iv) lack of awareness of franchise as a way of doing business; and (v) with 4.5 million inhabitants, Croatia is a small market thus being less attractive for the largest franchisors due to logistical problems. .

4. Conclusion

Franchise is a system of making business, which ensures easier start-up in entrepreneurship activity, as well as a safer way to survive there. Thus, it should be considered as a valuable tool for developing entrepreneurship and SME sector in Croatia.

Identified barriers to franchising growth can be overcome by developing legal and institutional framework, creating greater awareness of franchise as a way of doing business through seminars and round tables, as well as undertaking researches on franchise and its benefits for SME sector development

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