7 Franchising and Entrepreneurship

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Introduction

Within the marketing literature, franchising is described as a market entry mode, a channel of distribution, a vertical marketing system and a business format. What these different terms all reflect however, is a contractual agreement between two key stakeholders; a franchisor and a franchisee. One specific type of franchising, business format franchising, is a popular choice for hospitality and tourism firms seeking domestic and international expansion. Franchised firms now operate in over 160 countries worldwide (IFA, 2014) and play an important role in the growth of global entrepreneurship (Chirico *et al.*, 2011). Business format franchising is therefore recognised as a key opportunity for aspiring entrepreneurs (True *et al.*, 2003).

The purpose of this chapter is to develop your understanding of hospitality and tourism franchising from an entrepreneurial perspective. More specifically, by the end of this chapter you should be able to:

- Explain business format franchising and its growth within hospitality and tourism;
- Evaluate the potential benefits of business format franchising from different stakeholder and theoretical perspectives;
- Evaluate the role of franchisors and franchisees from an entrepreneurial perspective.

The chapter begins by defining business format franchising before examining its growth within hospitality and tourism. The potential benefits of franchising are then explained using popular franchise theories. Finally, the chapter considers the role of franchisors and franchisees as entrepreneurs, and franchising as an entrepreneurial partnership.

Business format franchising explained

In business format franchising, a franchisor develops a business concept which franchisees replicate and operate on the franchisor's behalf. The franchisor develops a brand name, a trade mark, a specific product and/or service, and a defined method for operating franchised units (Weaven and Frazer, 2003). The franchisor then sells the right to operate one or more units to franchisees for a contractually determined period of time. The franchisor normally provides the franchisee with initial training and detailed operating manuals, as well as ongoing operational, technical and marketing support. In return, the franchisee pays an upfront fee for the franchised unit and ongoing royalty fees based on a percentage of gross sales and advertising fees.

There are different variations of franchise contracts used within hospitality and tourism. While some franchisees operate as single-unit franchisees, others grow the number of units they operate sequentially over time to become multiple-unit franchisees (Grunhagen and Mittelstaidt, 2005). Some franchisors offer contracts which entitle the franchisee the rights to operate multiple franchised units (area franchise) and/or to grant these rights to third parties as sub-franchisors (master franchise) in a defined geographical territory (Brookes and Roper, 2011). These contracts often stipulate the number of units to be opened within a specified time frame. Text box 1 provides an overview and examples of the different types of franchising.

Text box 1: Types of franchising

Single Unit: a franchisee signs a contract to operate a single franchise unit. These agreements are used by franchise firms such as Pappa John's Pizza and Dairy Queen.

Multiple Unit: A franchisee signs one or more contracts to operate more than one franchise unit; units are frequently added sequentially over time. Subway franchisees frequently open subsequent units. Multi-unit franchise operators control 55% of all franchised units in the U.S.

Area Franchise (also called corporate): A franchisee signs a contract to develop and operate multiple franchised units over a defined geographical territory; development targets are frequently set by the franchisor. Yum Brands used this type of contract when entering China with the KFC franchise.

Master Franchise: A master franchisee signs a contract to operate multiple franchise units and/or sub-franchise units to other franchisees over a defined geographical territory; development targets are frequently set by the franchisor. Choice Hotels used these agreements when expanding into Europe.

The growth of franchising in hospitality and tourism

The development of the business format franchise model (as described above) is generally accredited to Ray Krok in the 1950s. Kroc recognised the ingenuity of the McDonald brothers fast-food formula for a limited menu and efficient customer service. He also identified a gap in the US market for restaurants that offered good service, value and cleanliness (mcdonalds.com, 2014). Realising the importance of maintaining quality through uniform standards of production, the business format franchise model was developed to expand McDonald's fast-food restaurants throughout the USA. This model grew rapidly in the fast-food sector as well as in quick-service restaurants, lodging and subsequently in travel and transportation, the cruise industry, campgrounds, event planning and other industrial sectors first in the USA and then internationally.

In Europe, franchising also became a popular business model. Today France, Germany and Spain boast the greatest number of franchise brands, although Belgium, Sweden and Poland have recently witnessed the largest franchise growth (EFF, 2011). In Australia, franchising began in the 1970s with the introduction of US fast-food chains like KFC and Pizza Hut and has continued to grow ever since. More recently franchising has grown rapidly in emerging markets such as Brazil, China and Turkey.

In many of these countries, hospitality and tourism franchises represent a significant proportion of the total franchise industry. In Brazil, hospitality and tourism represents approximately 27% of the franchise sector (Asgharian *et al*., 2013). The food and beverage sector in China represents 35% of the industry (IFA, 2014) and nearly one-half of the top 100 restaurants are franchised. KFC is the leading QSR restaurant in China with over 3400 outlets in 700 cities (Herman, 2014). In Spain, the retail and restaurant sector represent 40% of the franchise industry (Polo-Redondo *et al*., 2011) and in Saudi Arabia, 40% of the restaurant sector is franchised (Sadi and Henderson, 2011). In the USA, fast-food is the largest franchise sector and McDonalds, the largest franchisor (IFA, 2014). Hospitality and tourism franchise chains represent six of the top ten franchises in Entrepreneur's 2014 top 500 ranking and 38 of the top 100 in Franchise Direct (2014) global ranking. While most of these are food and beverage franchise chains, hotel groups such as Wyndham, InterContinental, Marriott, Hilton and Choice are also included. The on-going trend of separating hotel ownership from hotel management (Brookes and Roper, 2012) has helped to fuel franchise growth is this sector.

Business format franchising thus has its roots in hospitality and tourism and it remains a popular choice for many firms. The reasons for this popularity can be explained by the potential benefits it offers to the countries where it is established, as well as to franchisors and franchisees.