

Franchising has increasingly led aspiring entrepreneurs to realise their dreams of owning their own ventures. Today, Indian market ecosystem is perfect for developing innovative business formats and models. Even international players have contributed in the emergence of India as a central business hub, owing to the foreign investment policies and regulatory norms implications.

In India, franchising as a route of expansion has been prolific across sectors as well as formats. Industry verticals like education, F&B and fashion have been constantly leveraging their growth through various product/service franchising concepts. High resilience of franchised system during the recent economic downturn yet again proved the robustness of the model. Today, USD 7.2 billion franchising industry is yet to mature as a business practice. Though it is projected to grow around 35 per cent in the coming years, the policy makers are yet to realise the potential of franchising. Regulators must facilitate counter movement of capital as well as of technology that shall reshape the franchising construct.

On the steady path of growth, the game is changing at a rapid pace. Investors are becoming much more cautious and to establish a long-term profitable partnership, risk is shared both by the franchisor and the franchisee. Hence, involvement of both the stakeholders is essential to replicate successful business models as well as to create win-win synergies, which all franchise systems intend to realise.

Franchise Insights: Reading between the lines

Typically, it takes 10 years for an Indian retailer to start franchising. Most of the franchisors presently have been franchising since five years.

There is a huge probability that an average franchise opportunity can promise the investor 20-40 per cent returns on investment.

An increasing number of franchisors (53% of the sample) prefer high footfall areas such as residential markets to busy streets (29%) and malls (18%), as they do not have the disadvantage of high set-up cost.

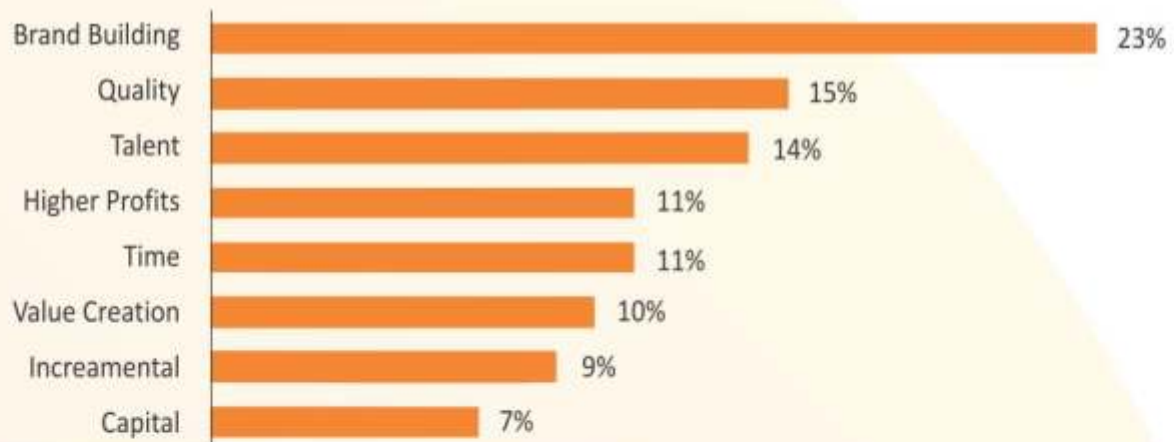
Both Franchise-owned Company-operated (FoCo) and Company-owned Franchise-operated (CoFo) are equally popular amongst franchisors as business models. While 38 per cent prefer FoCo, 35 per cent opt for CoFo. At the same time, 15 per cent of the survey sample prefer FoFo while 12 per cent has CoCo as its business model.

In India, the perceived fear of franchising has led to many myths about the model, like it's all about low-cost retail expansion, minimum guarantee clause, sporadic franchise recruitment and too much of face value contracts. IFA conducts various annual surveys to calibrate behaviour of companies foraying into chain store business through franchising. The recent surveys of a sample consisting of both established and debutant franchisors reveal surprising facts about realities of chain store expansion business and IFA's take on the same.

1. Franchisors franchise their business for brand-building

Defying the myth, the survey concluded that most of the franchisors are looking forward to building their brands through franchising. The next important reason for franchising was uniform quality (15%), which is against the common perception that franchising is done for capital constraints. It was least important. (7%). This aligns with the fact that most of the franchising companies are typically SMEs and have constrained marketing as well as branding budgets. It has been internationally discussed as well as established that franchising is a marketing tool.

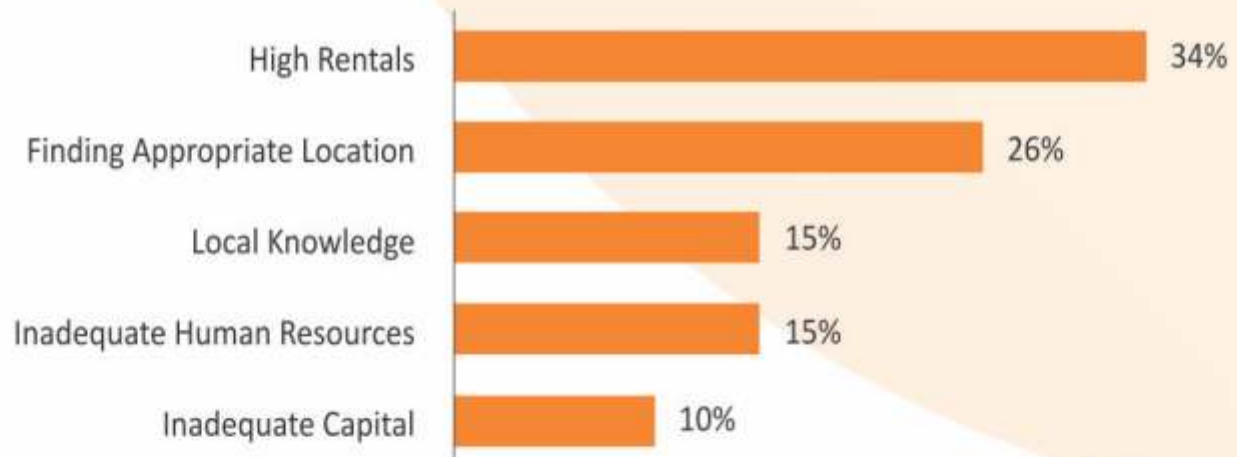
Reasons for Franchising



IFA perspective: Franchising can enable a concept to seek higher visibility and much vast product experience. Indian economy today presents readiness for new brand, product, concepts and experiences and hence, investments that go into brand development are bound to bring great returns in future. As responded by the majority, brand-building remains the primary reason for franchising. Nevertheless, franchising also ensures quality maintenance, attracts talent, fetches higher profits, reduces time to expand, creates value and additional revenue streams.

2. High rentals are the biggest challenge for business expansion

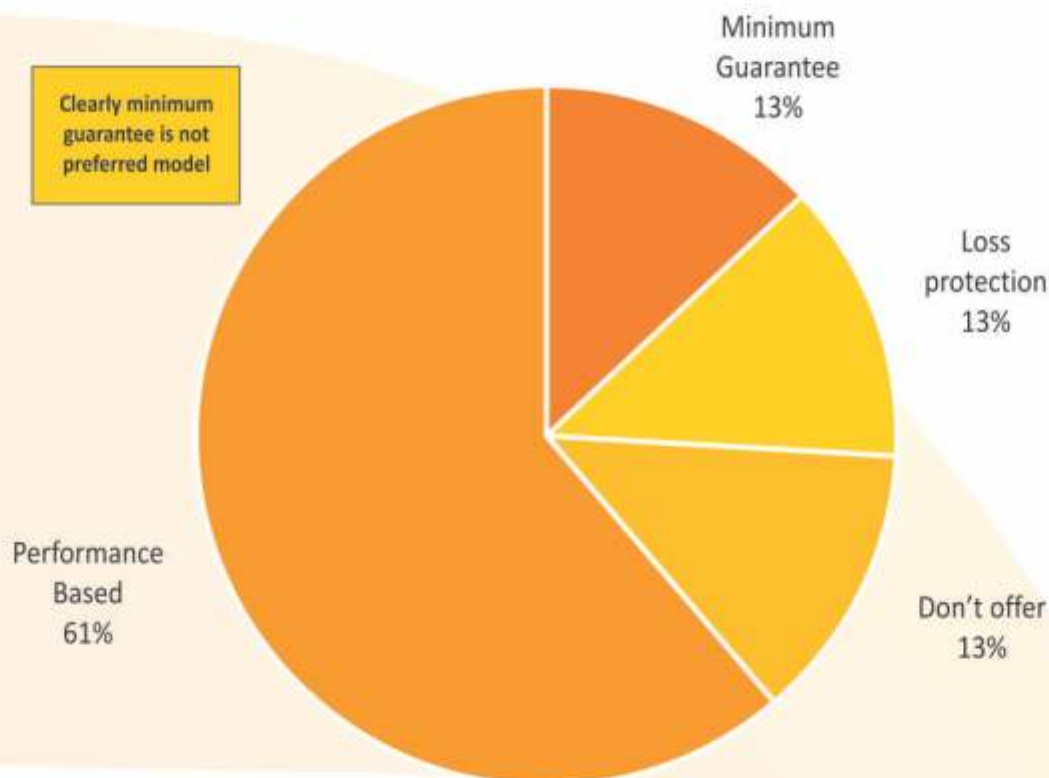
The topmost challenges faced by retailers are high rentals (34%) and finding appropriate location (26%). Incidentally, out of these two, retailers believe that though it is difficult to find an appropriate location due to real estate constraints, more difficult is to create a viable business model with high rental cost element. Local knowledge and inadequate human resources can be taken care of, feel most of the retailers and inadequate capital is the least perceived challenge by retailers for pan-India expansion.



IFA perspective: Paying higher rentals results in liquidity pressures. Major contributors to a retailers' cost include staff, power and marketing, which should ideally be 25 per cent of the sales. Real estate location is a strategic decision for chain store expansion. In case of small store rent, the amount should ideally be 10 per cent of the total proceeds from the business. On the flip side, expenditure on a good location is always in lieu of lower expenditure on pulling the footfall as well as higher visibility.

3. Franchisors are shunning Minimum Guarantee

Franchisors known for offering MGs are progressively moving away from the model (only 13 per cent of the survey sample prefers the model). A clear trend indicates inclination towards performance models (61%). This signals a clear scenario where franchising would mean proportional risk sharing amongst all stakeholders.

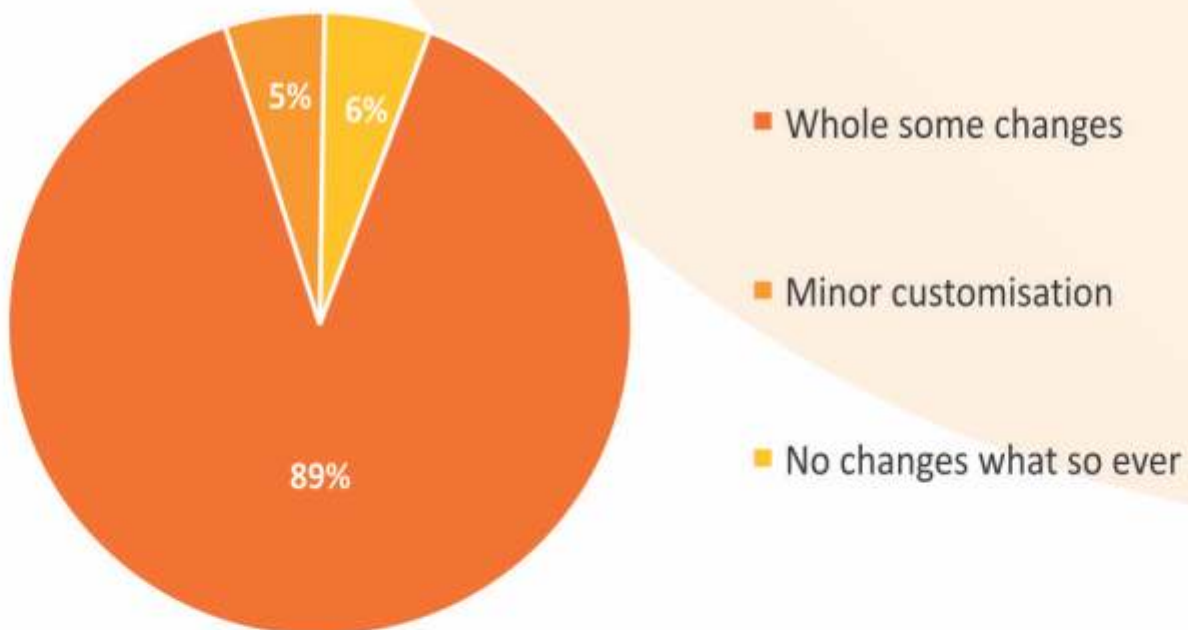


IFA perspective: Franchisors believing in the strength of their product/services are shifting to a risk-sharing model. However, Minimum Guarantee now has an evolved version like RoI guarantee, where franchisor ensures returns on investment in certain timeframe. It is required that the franchisee must become less-risk averse.

4. Ninety percent of franchisors customise their franchise proposal for investors

Before the franchisors settle down with the final franchise system for their organisations, they have to optimise the franchise proposal by making minor customisations, mostly on a case-to-case basis. Territorial exclusivity (54%) is one of the most negotiated terms in the franchise agreement. This is followed by franchise fee (36%) and initial investment (27%). Some of the other negotiated changes include the amount of royalty and place of outlet.

Extent of Changes in the intial franchise proposal

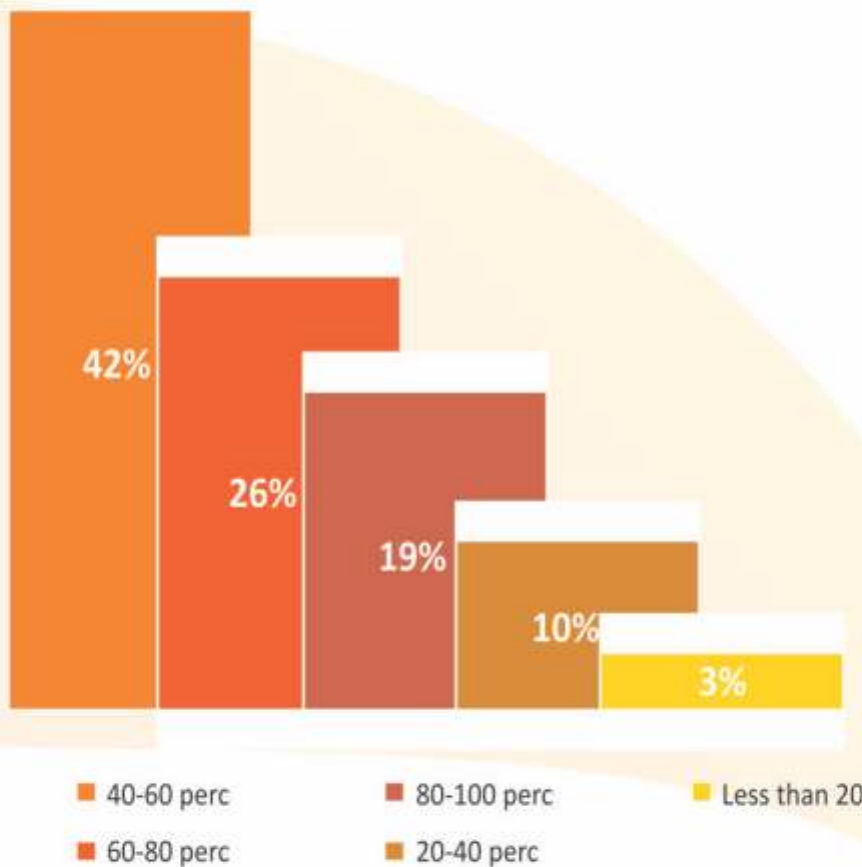


IFA perspective: Agreement Clause is a critical area for business, especially for the services and seeks due diligence. For instance, territory planning for a franchisor is essential, as gaps created due to mismanagement can have long-term implications. Hence, it is important for the franchisor to believe that it is rational to incorporate minor modifications and the investor too must be reasonable during such negotiations.

5. Majority of companies generate half of their revenue through franchising

As conveyed in the preceding discussion, franchising is done for reasons other than revenue generation, yet the fact that franchising creates an additional source of income remains significant. The survey brought out that most of the franchisors surveyed (42%) said 40-60 per cent of the revenue comes through franchising.

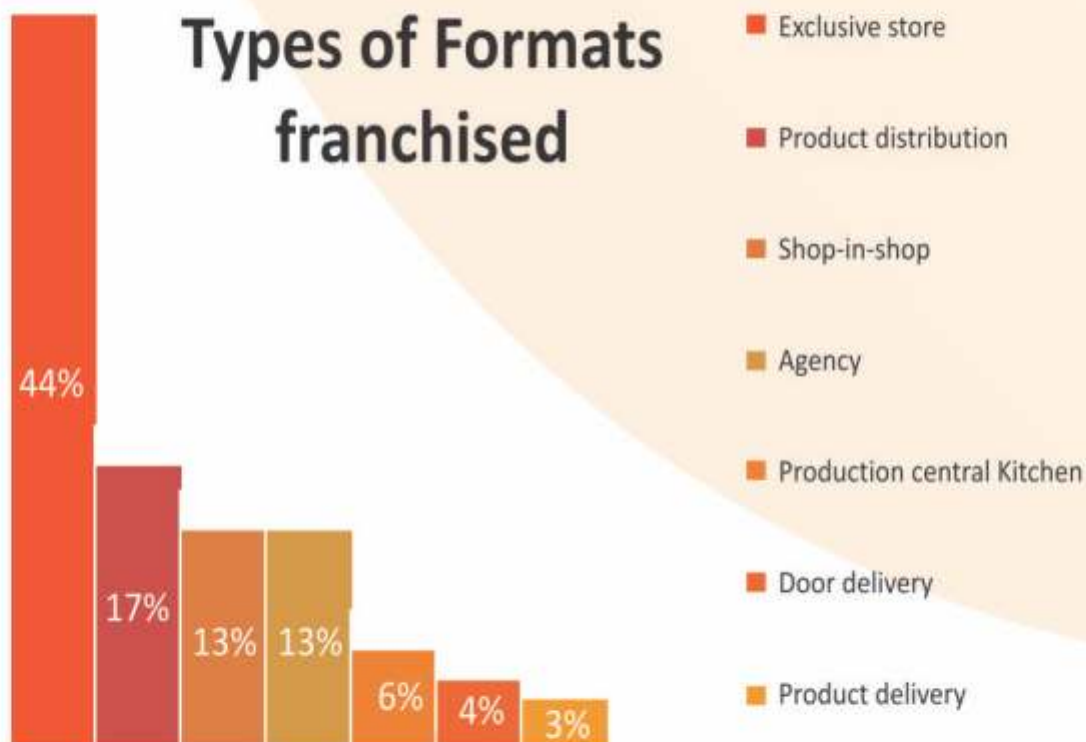
Business From Franchised Stores



IFA perspective: The business from franchise stores in most of the cases is more than 50 per cent, which further implies that franchise formats across all the verticals are a successful proposition, whilst operational and financial efficiencies are important for profitably sustaining the model.

6. Exclusive store is the most preferred mode of expansion

Though Indian franchise system can be divided into retail franchising and non-retail franchising, the major differentiating factor between the two is the priority given to the real estate. According to the IFA Franchisor survey, exclusive store formats are preferred by both. This is also augmented by the fact that most of the businesses venture into franchising for building as well as strengthening their brand.

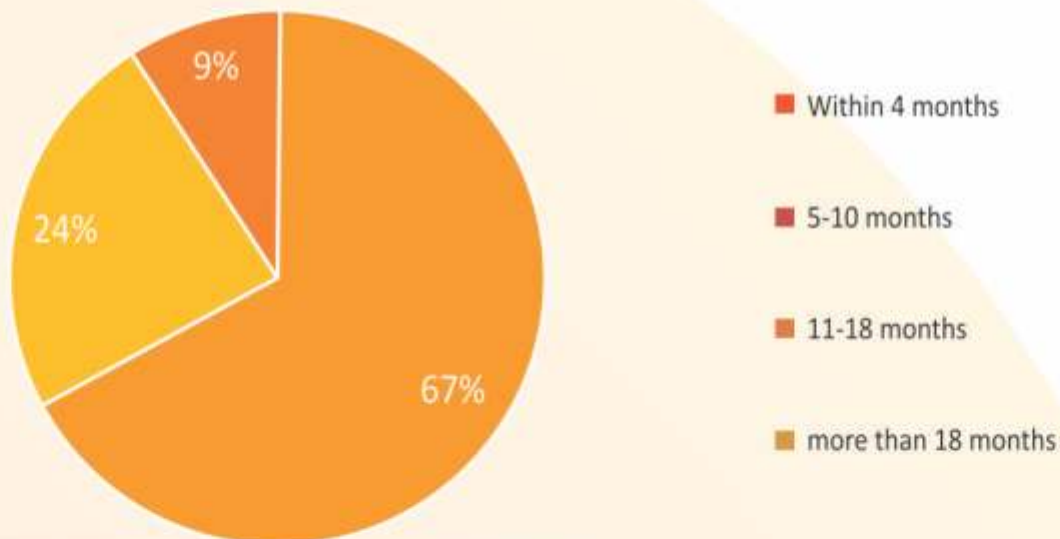


IFA perspective: Though an exclusive store remains a preferred choice, the constraint of real estate space invariably limits the exclusive store format. Shop-in shop format provides a respite and as market is also looking forward to concepts like co-branding, shop in-shops are just enablers for success of the concept. Another piece of observation is that agency model, which has been a prevalent way of doing business, is increasingly being discouraged.

7. It takes 5-10 months to appoint the first franchisee

Typically, when a franchisor launches his programme, he (67% of the respondents questioned) believes that he is able to recruit his first franchisee in 5-10 months. This is an indicator of the fact that acceptability of new business is relatively high in today's economy and an investor is normally ready to take a capital risk on innovative business model and formats.

Time taken for launch of the franchise program

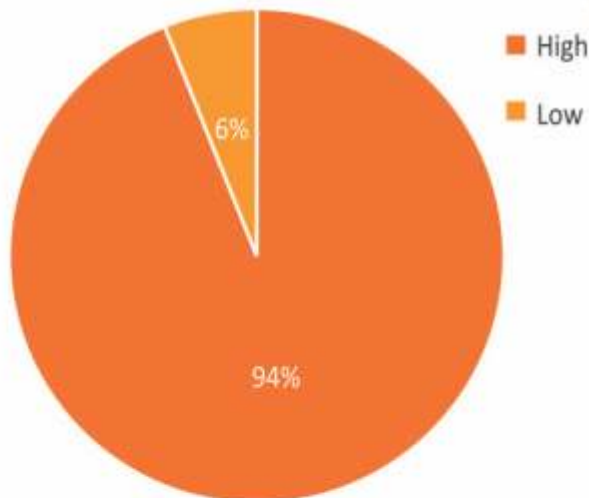


IFA perspective: Franchising is an optimised model for Indian entrepreneurs, who have large capital reserves but low risk appetite. However, a franchisor must be discreet and selective about recruiting his franchisees.

8. Ninety four per cent of the franchisors stay optimistic during recruitment process

Nearly all the franchisors, when asked if they ever thought of giving up franchising during the recruitment process, said no. This is an interesting indicator of good times ahead for small businesses. In the past decade, franchising has facilitated people with relatively small capital to invest in the economy and churn more capital into the market space. When Indian market today is receptive to exciting franchise concepts, franchise recruitment is no longer difficult.

Level of Optimism during the Franchise Recruitment Process

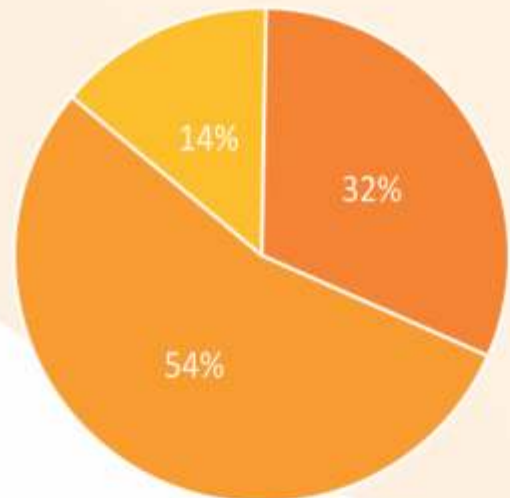


IFA perspective: Recruitment phase is a sensitive period for a franchisor, as it exposes their business systems and tests their capabilities. Unhealthy recruitment can have long-term implications and hence, franchise experts advise careful planning and execution. It is advised not to get swayed by the initial surge on investor leads.

9. Fifty four per cent of Indian franchisors rate themselves as moderately successful

As the experts put it, there are two golden rules of successful franchising. Franchisee should profitably sustain the franchise system and franchisor should profitably develop the franchise network. Apparently, franchisors are quite aggressive in their expansion plans.

Franchisor Self Rating/ Assesment



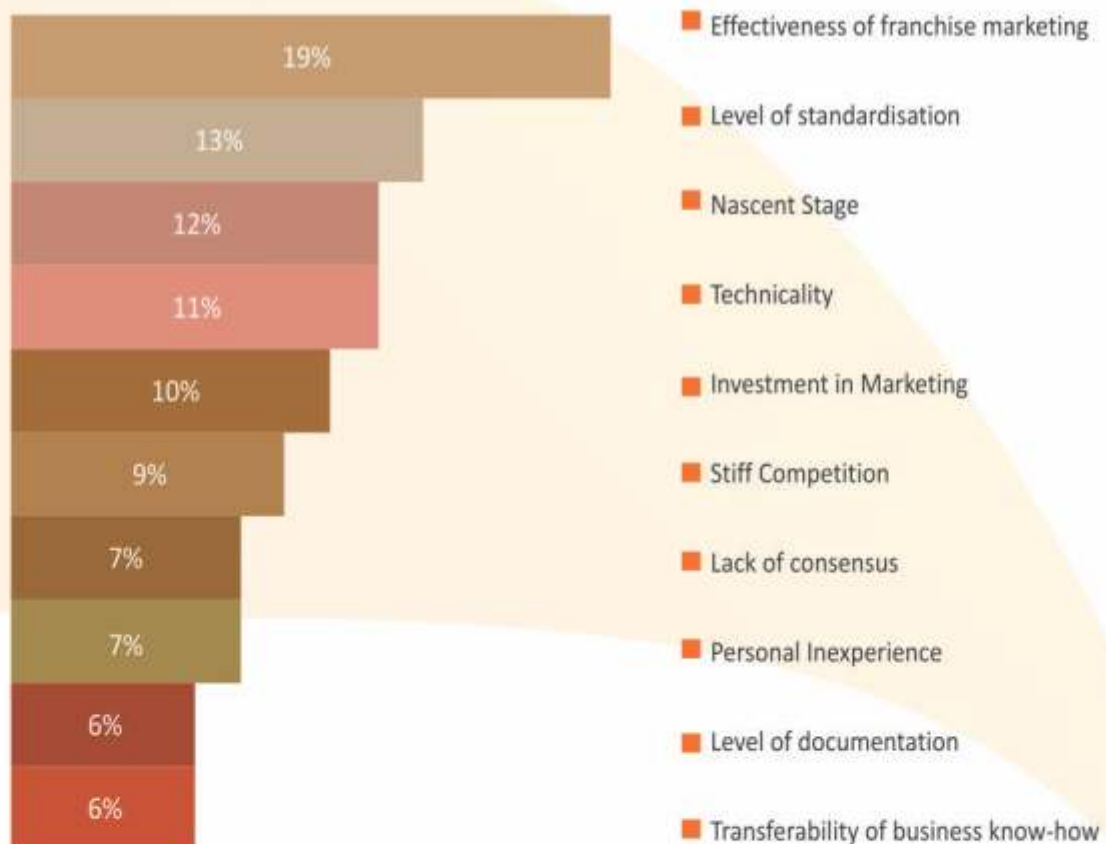
■ Highly successful
 ■ Moderately successful
 ■ Struggler

IFA perspective: The self-assessment by the franchisors is an indicator of how aggressive they believe themselves to be and how they perceive their success rates, which has come out to be moderate (54%). This further implies that the franchisors are realistic whilst being aggressive.

10. It's not easy to market and sell a franchise system

Generation of quality of investor leads and optimising the investment involved in effective franchise marketing makes franchise marketing a challenging activity. The assumption that franchise expansion is relatively easy has led to a lot of unhealthy franchising. Marketing a franchise opportunity would not only mean selling the original business concept/product, but also selling the franchise system to a prospective investor. Generation of genuinely interested investor leads and soft selling them the business proposition need considerable marketing expense and an increasing number of franchisors are waking up to this fact. A certain percentage of franchisors also believe that investment in marketing is a challenge, which happens to be a high priority expectation of a franchise investor. Hence, there exists a visible need gap, which can have serious implications on the long-term expectations of the franchisees.

Challenges in Franchising



IFA perspective: While structuring the business model, a franchisor must keep robustness in the system. Training across the franchise systems is the need of the hour. Well-trained franchise workforce is in huge demand, as the skill is limited in the Indian market.



Contact us to make an informed decision!

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