GLOBAL FRANCHISING OPERATIONS MANAGEMENT

Cases in Franchise, International, and Emerging Markets Operations

ILAN ALON

Consulting Editor, Barry Render, Ph.D.
Praise for

Global Franchising Operations Management

“While much has been published in franchising over the years, this book, for perhaps the first time, recognizes the important role franchising is playing in developing countries and emerging markets around the world. As a franchise consultant for close to 30 years, I found the case studies to be as fascinating as they were informative.”

—Mark C. Siebert, CEO, The iFranchise Group, Inc., www.ifranchisegroup.com, USA

“Ilan Alon, a superb researcher and scholar on international business and franchising, continues to add significantly to the field in his new publication, Global Franchising Operations Management. A prolific writer with experience in Asia, Europe, and the Middle East, Ilan has published more than 100 articles in prestigious and diverse international journals in addition to authoring many noteworthy books.”

—Cheryl R. Babcock, CFE, Director, International Institute for Franchise Education (IIFe), H. Wayne Huizenga School of Business & Entrepreneurship; Executive Director, International Society of Franchising (ISoF), USA

“Franchising is booming everywhere—in most countries of the world (developed and emerging markets) and most industries (retailing and services). The cases presented in this book cover many countries, many industries, and many topics of interest for the franchising practitioners. The relevant analysis of these cases by Dr. Ilan Alon gives an overview of the various issues (marketing, management, logistics…) faced by franchisors when internationalizing their network. This book contributes to the better understanding of practitioners (franchisors, franchisees…) and also students regarding franchising globally.”

—Dr. Rozenn Perrigot, Associate Professor and Head of the MSc in Franchising at the Graduate School of Management at the University of Rennes 1 in France, Researcher at the Center for Research in Economics and Management (CREM UMR CNRS 6211), and Consultant in Franchising

“This is an important contribution to the field of international franchising knowledge and education. The case studies presented illuminate a wide gambit of issues facing prospective and existing franchisors and franchisees alike. Coupled with the wide range of business types, stages of development, countries and contexts discussed, the issues raised expose the reader to many crucial and contemporary franchising questions. At the same time, the reader comes away with some very interesting insights into the franchising programs of some well-known companies, like Marks and Spencer, Kodak Express, and The Athlete’s Foot.”

—Callum Floyd, Director, Franchise Consultants, New Zealand
“Dr. Ilan Alon is the authority in relation to international franchising and emerging markets. His depth of knowledge and practical advice, guidance, and insight are invaluable. Global Franchising Operations Management is an essential resource for any franchise professional engaged in international development.”

—Paul Cairnie, CEO, World Franchise Associates, Ukraine

“Franchise professionals will appreciate the inside information…it’s not only educational, it’s also entertaining (which makes me wish I had been one of the contributors).”


“This book is really interesting, especially for aspiring entrepreneurs and franchise professionals. Ilan Alon seeks to provide a framework for franchisors who wish to expand their brand locally as well as internationally. I highly recommend this book.”

—Dhawal Shah, Founder, Way2Franchise, India

“Groundbreaking, critical information on franchising. A must-read!”

—Dianne H.B. Welsh, Ph.D., Hayes Distinguished Professor of Entrepreneurship, Director of Cross-Disciplinary Programs, The University of North Carolina Greensboro, USA
Global Franchising
Operations Management
Global Franchising
Operations Management

Cases in International and Emerging Markets Operations

Ilan Alon
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Table of Contents

Chapter 1  Introduction ................................................. 1

Part I: To Franchise or Not to Franchise

Chapter 2  San Francisco Coffee House: An American Style Franchise in Croatia ......................... 19
            Ilan Alon, Mirela Alpeza, and Aleksandar Erceg

Chapter 3  Trying To Create a Stir: Opening a Coffee Shop in Korea ........................................ 35
            Gyewan Moon and Allen H. Kupetz

Chapter 4  International Marketing and Franchising at Marks & Spencer ............................. 49
            Ilan Alon

Part II: In Search of Global Opportunities

Chapter 5  Estimating Demand in Emerging Markets for Kodak Express ............................. 75
            David M. Currie and Ilan Alon

Chapter 6  Ruth’s Chris Steak House: The High Stakes of International Expansion .................. 87
            Allen H. Kupetz and Ilan Alon

Part III: Franchising in Emerging Markets and Developing Countries

Chapter 7  Master International Franchising in China:
            The Athlete’s Foot, Inc. (Part A) ....................... 101
            Amber Xu and Ilan Alon
Chapter 8  Master International Franchising in China:
The Athlete’s Foot, Inc. (Part B)  119
Amber Xu and Ilan Alon

Chapter 9  Social Entrepreneurship and Sustainable Farming in Indonesia  125
Ilan Alon and Eve Misati

Chapter 10  Final Reflections and Epilogues  145

Index  185
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Allen H. Kupetz (United States)
Amber Xu (China)
David M. Currie (United States)
Eve Misati (United States)
Mirla Alpeza (Croatia)

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Dr. Alon has developed and taught franchising courses in China (Fudan University and China Europe International Business School, CEIBS), Italy (MIB School of Management), Germany (Jacobs University), and India (Integrated Institute for Learning and Management, IILM). He has lectured extensively on franchising in various professional associations, including the International Franchise Association, International Society for Franchising, and the Academy of International Business.

Dr. Alon consulted USAID on franchising development in emerging markets. In Croatia, he aided in the development of the field of franchising through education to bankers, business consultants, and lawyers and provided support for budding home-grown franchisors. He has also consulted multinational companies, such as Duhan (Croatia) and illy (Italy), to develop their franchising systems.

A prolific author on Global Franchising, Dr. Alon’s books include:

*Franchising Globally: Innovation, Learning and Imitation* (Palgrave, 2010)

*Service Franchising: A Global Perspective* (Springer, 2005)


*International Franchising in Industrialized Markets: North America, Pacific Rim and Other Developed Countries* (CCH Inc., 2002)

*International Franchising in Emerging Markets: China, India, and Other Asian Countries* (CCH Inc., 2001)

*International Franchising in Emerging Markets: Central and Eastern Europe and Latin America* (CCH Inc., 2001)

*The Internationalization of US Franchising Systems* (Garland Publishing, 1999)
Introduction

What is a franchise? According to the International Franchise Association, the industry’s lobby group, “A franchise is the agreement or license between two legally independent parties which gives:

- A person or group of people (franchisee) the right to market a product or service using the trademark or trade name of another business (franchisor)
- The franchisee the right to market a product or service using the operating methods of the franchisor
- The franchisee the obligation to pay the franchisor fees for these rights
- The franchisor the obligation to provide rights and support to franchisees

Franchising is a commercial relationship between two entities in which one of the entities, the franchisor, grants the other entity, the franchisee, the right to use its commercial and intellectual assets for a period of time in return for fees and royalties. Fees are often expressed as a fixed sum paid in advance, and royalties are often expressed as a percentage of gross revenues. The nature of the relationship between the franchisor and the franchisee is determined by the institutions that govern franchising—franchise law, as well as the personal and commercial relations developed between the franchisee and the franchisor. Because franchising is often defined by the legal environment, multiple variations exist. Italian franchising law promulgated in April of 2004, for example, defines franchising as “a contract by which one
party grants to the other, for a consideration, the use of combination of intellectual property and/or industrial rights, know-how, technical and commercial assistance, as well as the opportunity to be part of a franchising network.” Governance by contract means that appropriate institutions to enforce and support franchising should exist. The contract defines the roles and obligations of the parties.

Franchising is a hybrid form of business. It requires the franchisee to follow the rules of operations, or the franchisee may lose his/her rights to the franchise. In this way, franchising is less entrepreneurial than the stand-alone business. However, the franchisee is often an owner-operator who has a significant investment, both in time and money, built into the system. The franchisee’s engagement with the business—taking risks, solving problems, and operating the business—qualifies him/her as an entrepreneur. Because the franchisee has no boss in the traditional sense, he/she is really not an employee. Therefore, the franchisee is somewhere between being an employee (whose actions are monitored and controlled) to an entrepreneur (whose actions lead to residual income). In this way, franchising possesses both marketlike relations and firmlike relations. The extent to which franchisees can act entrepreneurially depends on the size of the franchisor, how franchising is embedded within the franchisor, the legal relationship, the operational autonomy, the commercial interdependence, and the extent of mutual benefits.

From an operations perspective, franchising is a systematized method of transferring organizational know-how to agents (franchisees) while minimizing the risks involved in making investments. To the marketers, franchising is a way to reach optimal distribution, perhaps in areas where the company’s own tentacles cannot overreach. Franchising can also be viewed as a financial vehicle for both passive and active investors. Real estate developers might want to buy the rights to develop certain retail concepts when building a regional
mall, for example. Such developers often buy multiple units at a time and multiple concepts to fit their desired developmental plans. Master international franchising has become the most popular method for expanding overseas as it allows one entity the control and responsibility for the development of entire countries or regions within countries. In short, franchising is a contractual agreement, a hybrid form of business, a method of distribution, a mode of entry into a new country, a financial investment, and a method of operations.

There are various advantages and disadvantages to the franchisor and the franchisee. The franchisee’s biggest benefit is the slogan used by the industry: “be in business for yourself but not by yourself.” The franchisee can benefit from the franchisors’ brand-name recognition, proven products and methods, proven marketing systems, proven technology, know-how and competitiveness in the industry, financial assistance from the franchisor or a banking affiliate, pooled resources, and economies of scale in advertising and buying. However, the franchise dream is sometime unfulfilled as the franchisee finds that results are based on hard work and resource commitment is insufficient. Fees and royalties have to be paid, contractually, even if the residual income of the franchisee is nonexistent. The franchisor has much power over the franchisee’s operations, contract, and, therefore, in legal disputes.

In addition, many benefits accrue to the franchisor. Franchisors who reach a critical level of output can spread the fixed costs over a greater number of outlets, giving them a competitive cost structure. Increased purchasing power against suppliers, economies of scale, additional capital, and the potential to expand the brand quickly are some of the benefits of franchising. On the other hand, franchisors are sometimes troubled by monitoring the franchisees’ actions, controlling quality, protecting their brand, getting into legal disputes, sharing revenues with franchisees, creating new future competitors,
and limiting operational flexibility. Conflict with franchisees can lead to dissolution for a small franchisor. Failure to control for quality can lead to the deterioration of the total brand and to eventual closure.

Like a marriage, the focus of successful franchising relies on the ability of the partners to work together harmoniously. This means that franchisees are empowered and engaged, that there is a mutual commitment from both sides, and that relational norms embody flexibility and trust. Cooperative relations emerge from good franchisee selection and training, shared decision making, adherence to ethical standards, and, perhaps most important, profitable businesses.

Franchising is a huge part of the modern global economy. In the U.S. economy alone, it represents about 785 million establishments with an output that approaches $740 billion (see Table 1.1). International markets for franchising are also growing. In the United States, franchising accounts for nearly 18 million jobs (1 of 8) and a $2.1 trillion contribution to output² (see Table 1.2). Although reliable statistics are not available, several books have documented international growth in recent years through a variety of country and industry studies.³ See Table 1.3 for franchise associations around the world.
<table>
<thead>
<tr>
<th>Business Lines</th>
<th>Establishments</th>
<th>Percent Change Over Prior Year</th>
<th>Employment (Thousands)</th>
<th>Percent Change Over Prior Year</th>
<th>Output (Billions of Dollars)</th>
<th>Percent Change Over Prior Year</th>
<th>(Billions of Dollars)</th>
<th>Percent Change Over Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Automotive</td>
<td>31,659</td>
<td>3.9%</td>
<td>$185</td>
<td>3.9%</td>
<td>$39.7</td>
<td>7.2%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business services</td>
<td>92,714</td>
<td>−0.2%</td>
<td>$819</td>
<td>−0.2%</td>
<td>$128.7</td>
<td>3.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial and residential services</td>
<td>70,129</td>
<td>3.7%</td>
<td>$281</td>
<td>3.7%</td>
<td>$45.8</td>
<td>6.9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lodging</td>
<td>26,011</td>
<td>4.4%</td>
<td>$711</td>
<td>4.4%</td>
<td>$70.8</td>
<td>4.0%</td>
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<td></td>
</tr>
<tr>
<td>Personal services</td>
<td>130,895</td>
<td>2.5%</td>
<td>$602</td>
<td>2.5%</td>
<td>$86.2</td>
<td>6.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Quick service restaurants</td>
<td>152,665</td>
<td>2.6%</td>
<td>$2,982</td>
<td>2.6%</td>
<td>$194.0</td>
<td>4.9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real estate</td>
<td>86,825</td>
<td>1.1%</td>
<td>$341</td>
<td>1.1%</td>
<td>$51.2</td>
<td>0.1%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retail food</td>
<td>60,841</td>
<td>3.2%</td>
<td>$484</td>
<td>3.2%</td>
<td>$38.2</td>
<td>6.2%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retail products and services</td>
<td>99,592</td>
<td>3.9%</td>
<td>$402</td>
<td>3.9%</td>
<td>$29.5</td>
<td>5.7%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Table/full service restaurants</td>
<td>33,471</td>
<td>2.3%</td>
<td>$1,003</td>
<td>2.3%</td>
<td>$55.7</td>
<td>4.6%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>784,802</td>
<td>2.5%</td>
<td>$7,808</td>
<td>2.5%</td>
<td>$739.9</td>
<td>4.7%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Table 1.2  U.S. Jobs and Output from Franchising

<table>
<thead>
<tr>
<th>Percent of U.S. Nonfarm Private Sector</th>
<th>Because of Franchised Businesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jobs 11.8%</td>
<td>17,430,700</td>
</tr>
<tr>
<td>Payroll 9.7%</td>
<td>$707.6 billion</td>
</tr>
<tr>
<td>Output 9.0%</td>
<td>$2.1 trillion</td>
</tr>
<tr>
<td>GDP 9.7%</td>
<td>$1.2 trillion</td>
</tr>
</tbody>
</table>

This book is divided into three parts:

Part I: To Franchise or Not to Franchise

Part II: In Search of Global Opportunities

Part III: Franchising in Emerging Markets and Developing Countries

Multiple franchising systems from different industries (coffee, supermarket, clothing, photography, food, athletic wear, and farming) and different countries (Croatia, Korea, United Kingdom, United States, China, and Indonesia) are represented. The diversity of companies/industries and countries in this book gives a panoramic overview of franchising around the world, across both time and space. Executives who read this book will learn about franchising success and failures through case studies. Students of franchising will learn the key success factors of franchising around the world, best practices, and will be given the opportunity to identify franchising problems and solutions. The last chapter of the book provides insight into each of the cases along with the epilogue based on what happened after the case was written.

The first part of the book discusses the decision to franchise and offers chapters with cases on coffee franchising in Croatia and Korea, as well as an example of a large UK retailer. The first two cases, featured in Chapters 2, “San Francisco Coffee House: An American-Style Franchise in Croatia,” and 3, “Trying to Create a Stir: Opening a Coffee Shop in Korea,” examine the decision to franchise from both
the franchisor point of view and the franchisee point of view. In Chapter 2, the franchisor has developed a franchise system, but the system is new and the environment is not auspicious to franchising due to its immaturity and lack of supporting institutions. In the case, Tensek and Pacek are faced with the problem of should they franchise or not and, if so, how should they go about doing so. Chapter 3 supplements Chapter 2’s case very well because it focuses on the franchisee perspective, looking at the same industry. There, two would-be entrepreneurs, Min-Guk “MG” Kim and Kevin Andes, attempt to evaluate whether to buy a coffee franchise in Korea. Both domestic and foreign options existed, as well as the option to open their own storefront. Chapter 4, “International Marketing and Franchising at Marks & Spencer,” is differentiated from Chapters 2 and 3 as it shows how franchising is implemented in a large corporate setting. M&S is the largest UK retailer and franchising is only used in the international marketplace, in places that the company does not want to invest because of a limited market and/or high exposure to risk. Franchising has a trade-off between risk and return. While the financial risks are relatively low, the potential return is limited to the royalty stream.

Part II of the book specifically deals with the international environment, first by measuring potential demand in Chapter 5, “Estimating Demand in Emerging Markets for Kodak Express,” for Kodak Express, and then selecting an international market for a steak concept from the United States in Chapter 6, “Ruth’s Chris Steak House: The High Stakes of International Expansion.” Market assessment and selection are interrelated aspects of successful internationalization. Estimating the potential demand is one of the prerequisites for targeting a country for international expansion. The case in Chapter 5 shows how companies can use country-level statistics to estimate the potential demand. Using income distribution and family size, the case shows how to calculate the economic potential starting with GDP. Making some assumptions about income elasticity of demand, the manager can estimate the market potential for a concept. Chapter 6
presents the analyst with the problem of how to target a country using a restaurant concept as a case. Using statistics on beef consumption and income per capita, the analyst is asked to choose the most appropriate markets for expansion, where the manager is expected to make an investment.

The third and final part of the book focuses on franchising in emerging markets and developing countries. Multiunit franchising arrangements are popular among emerging markets and developing countries. In these markets, a franchisee may be a company or a rich individual or family business that is able to purchase and develop the region. The company is often connected to the local culture and customs and is able to make the adaptations needed as well as monitor and control the system expansion. In a sense, the master franchisee becomes the subfranchisor in a given location. The master franchisee collects the fees, shares the royalties with the franchisor, and is responsible to the administration and management of the system in the host market. Chapters 7, “Master International Franchising in China: The Athlete’s Foot, Inc. (Part A),” and 8, “Master International Franchising in China: The Athlete’s Foot, Inc. (Part B),” feature the case of a master franchisee Rick Wang, owner of RetailCo, who franchised the American Athlete’s Foot concept in China. At the time of entry, the situation was ideal, large pent-up demand for branded athletic shoes was matched by opening for space in department stores and on street fronts. Shortly after opening and expanding the Athlete’s Foot system in China, Rick got into trouble and started to lose sales to the brands themselves that opened direct channels to the consumers. How Rick has managed to avoid financial collapse is instructive to would-be master franchisees considering a purchase of a foreign system into an emerging market. The last case, presented in Chapter 9, “Social Entrepreneurship and Sustainable Farming in Indonesia,” shows how franchising can be used to create social change. In this organic farming case situated in Indonesia, microfranchising is proposed as a
model to expand this social business. Microfranchising is franchising for the bottom of the pyramid and these businesses attempt to be inclusive to the poorest.

Collectively, the cases presented in these chapters show managers how to think about franchising from a multinational and multi-industry perspective. Both franchisee and franchisor considerations and problems are discussed. The final chapter shows what has actually transpired and provides an analysis and epilogue, where available, for each of the cases. It is hoped that this book, along with the cases presented, will show future practitioners how to franchise, under different institutional environments, and how to select and operate in different world markets.

Table 1.3  National Franchise Associations, Members of World Franchise Council, WFC

<table>
<thead>
<tr>
<th>Country</th>
<th>Association</th>
<th>Chairperson</th>
<th>President/CEO</th>
<th>Website</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>ARGENTINA</td>
<td>Argentinean Franchise Association (AAF)</td>
<td>Lucas Secades</td>
<td></td>
<td><a href="http://www.aafranchising.com">www.aafranchising.com</a></td>
<td><a href="mailto:info@aafranchising.com.ar">info@aafranchising.com.ar</a></td>
</tr>
<tr>
<td>AUSTRALIA</td>
<td>Franchise Council of Australia (FCA)</td>
<td>George Yammouni</td>
<td>Steve Wright</td>
<td><a href="http://www.franchise.org.au">www.franchise.org.au</a></td>
<td><a href="mailto:info@franchise.org.au">info@franchise.org.au</a></td>
</tr>
<tr>
<td>AUSTRIA</td>
<td>Austrian Franchise Association</td>
<td>Andreas Schwerla</td>
<td></td>
<td><a href="mailto:susanne.seifert@franchise.at">susanne.seifert@franchise.at</a></td>
<td><a href="mailto:oefv@franchise.at">oefv@franchise.at</a></td>
</tr>
<tr>
<td>BELGIUM</td>
<td>Belgian Franchise Federation (BFF)</td>
<td>Didier Depreay</td>
<td>Gilbert Lardinois</td>
<td><a href="http://www.fbf-bff.be">www.fbf-bff.be</a></td>
<td></td>
</tr>
</tbody>
</table>
BRAZIL—Brazilian Franchise Association (ABF)
Ricardo Bomeny, Chairman
Ricardo Camargo, Executive Director
www.abf.com.br
abf@abf.com.br

CANADA—Canadian Franchise Association (CFA)
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info@franchise.hu

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www.fai.co.in

ITALY—Italian Franchise Association (AIF)
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Italo Bussoli, Managing Director
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assofranchising@assofranchising.it

JAPAN—Japanese Franchise Association (JFA)
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www.jfa-fc.or.jp

KAZAKHSTAN—Kazakhstan Franchise Association
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Web site not available

KOREA—Korean Franchise Association (KFA)
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Park Kee Young, Vice Chairman
kypark@gymboree.co.kr
www.ikfa.or.kr

LEBANON—Lebanese Franchise Association (LFA)
Charles Arbid, Chairman
www.lfalebanon.com
president@lfalebanon.com

MALAYSIA—Malaysian Franchise Association (MFA)
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Ahmad Faizal Mohamed Noor, General Manager
www.mfa.org.my
wfc.affairs@mfa.org.my
MEXICO—Mexican Franchise Association (MFA)
Diego Elizarraras, Chairman
www.franquiciasdemexico.org
Presidencia@franquiciasdemexico.org

MORROCO—Moroccan Franchise Association (FMF)
Miss Btissam Omari
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omari@fmf.ma

NETHERLANDS—Netherlands Franchise Association
Maarten Dorhout Mees, Chairman
Jos Burgers, Executive Director
www.nfv.nl
info@nfv.nl

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Endnotes

   (accessed July 8, 2011)

   (accessed July 8, 2011)
Index

A

AAF (Argentinean Franchise Association), 9
Abdul Malik Abdullah, 12
ABF (Brazilian Franchise Association), 10
AEFRAN (Ecuadorian Franchise Association), 10
Ahmad Faizal Mohamed Noor, 10
AIF (Italian Franchise Association), 12
Andes, Kevin, 35-36, 156
Antunes, P., 13
APF (Portuguese Franchise Association), 13
Argentinean Franchise Association (AAF), 9
Asia, Marks & Spencer entry into, 61-62. See also China; South Korea
The Athlete’s Foot, Inc., 101
business operations, 172-176
country background, 104-106
countries with store locations, 103
FitPrint System, 105
franchise relationship, 171-172
franchises in China
 expansion strategy, 112-114
 market environment, 111-112
 opening of master franchise, 102-111, 106-108
 pressures, 114-121
struggle for survival, 119-121
termination of franchising relationship, 121-123
market opportunity, 170-171
opportunities for international growth, 169-176
Austrian Franchise Association, 9
average household size for selected countries, 82
Aydin, Mustafa, 14

B

Bali
rice farming in, 134-136
Sari Organik Farm. See Sari Organik Farm
village system, 137
Bamjar (Bali), 137
barriers to franchise development
in Croatia, 28-30
in South Korea, 42-43
Belgian Franchise Federation (BFF), 9
Benfield, James, 65, 159
BFA (British Franchise Association), 11
BFF (Belgian Franchise Federation), 9
Billings, Graham, 10
Bodag Maliah, 128
Bomeny, Ricardo, 10
Brazilian Franchise Association (ABF), 10
British Franchise Association (BFA), 11
Broderson, Torben L., 10
Brooks Brothers, 60-63
Burgers, Jos, 10
Bussoli, Italo, 10

C

CAF (Czech Franchise Association), 10
CAF/FIP (Croatian Franchise Association), 10
calculating potential demand, 83-85
Canada, Marks & Spencer entry into, 59-61
Canadian Franchise Association (CFA), 10
Canadian People’s Department Stores, 59
Carmi, Oded, 125-126, 176-181.
See also Sari Organik Farm
corporate social responsibility (CSR), 132
social entrepreneurship background, 126-128
CCFA (Chain-Store & Franchise Association), 10
CFA (Canadian Franchise Association), 10
Chain-Store & Franchise Association (CCFA), 10
Chandroo, C., 13
China
The Athlete’s Foot, Inc. entry into, 111-112
franchising in Chinese market, 102-111
opening of master franchise, 106-108
pressures, 114-121
struggle for survival, 119-121
termination of franchising relationship, 121-123
The Athlete’s Foot, Inc. expansion strategy in, 112-114
Chopra, Carol, 10
Chow, Charlotte, 11
Chung-Jen Hsu, 14
Coffee Been Korea, 43
coffee shop franchises
opportunities in South Korea, 35-36, 156-158
coffee prices, 42
coffee shop brands, 40-41
coffee shop culture, 39
college market, 38
economic environment, 37
food available at major Korean coffee shops, 45-46
possibility of franchising major Korean coffee shops brands, 43-44
San Francisco Coffee House (Croatia)
barriers to franchise development, 28-30, 32
competition, 30-32
economic environment, 24-25
expected revenues and expenses, 33
financial performance, 23
opening of, 21-23
political environment, 26
procedure for engaging franchises, 147-155
startup, 19-21
stimulating franchise development, 26-28
college market in South Korea, 38
competition, San Francisco Coffee House (Croatia) case study, 30-32
Corliss, Robert J., 105
corporate culture, Marks & Spencer, 66
corporate social responsibility (CSR), 132
Croatia
domestic franchisors in, 30
foreign franchisors in, 30
San Francisco Coffee House, 21-23
barriers to franchise development, 28-30, 32
competition, 30-32
economic environment, 24-25
employees, 23
expected revenues and expenses, 33
financial performance, 23
opening of, 21-23
political environment, 26
procedure for engaging franchises, 147-155
startup, 19-21
stimulating franchise development, 26-28
Croatian Franchise Association (CAF/FIP), 10, 27, 30
CSR (corporate social responsibility), 132
Czech Franchise Association (CAF), 10

D
D’Allaird’s, 59
Danish Franchise Association (DFA), 10
Davies, George, 161
definition of franchising, 1-3
demand in emerging markets, estimating, 75-76
Depreay, Didier, 9
Desa (Bali), 137
DFA (Danish Franchise Association), 11
DFV (German Franchise Association), 11
diversification model, Ruth’s Chris Steak House, 93
Donat, Gurkan, 10

E
Eastman, George, 77
Eastman Kodak Corporation
global strategy, 76-77
Kodak Express. See Kodak Express
economic environment
Croatia, 24-25
South Korea, 37
economics of franchising
growth of franchising in U.S., 4
U.S. jobs from franchising, 4
Ecuadorian Franchise Association (AEFRAN), 10
Edge, Hoyt, 141
EFDA (Egyptian Franchise Development Association), 10
EFF (European Franchise Federation), 11
Egyptian Franchise Development Association (EFDA), 10
Elashvili, Merab, 13
Elizarraras, Diego, 13
estimating demand in emerging markets, 75-76
Estrada, Chit, 10
Euris, 105
Europe, Marks & Spencer entry into, 61-62
European Franchise Federation (EFF), 11

F
FAI (Franchise Association of India), 12
FANZ (Franchise Association of New Zealand), 13
Far East, Marks & Spencer entry into, 61-62
FASA (Franchise Association of South Africa), 14
FCA (Franchise Council of Australia), 10
Fertel, Ruth, 87-90. See also Ruth’s Chris Steak House
FFF (Finnish Franchising Association), 11
FFF (French Franchise Federation), 11
financial services at Marks & Spencer, 53
Finnish Franchising Association (FFF), 11
Fiorelli, G., 12
FitPrint System, 105
FLA (Franchising and Licensing Association), 13
FMF (Moroccan Franchise Association), 13
food available at major Korean coffee shops, 45-46
forecasted GDP purchasing power parity per capita for selected countries, 2016, 85
forecasted population for selected countries for 2016, 84
Foremost Dairies Ltd., 102
Fornetti, expansion into Croatia, 30 franchise, definition, 1-3
Franchise Association of India (FAI), 12
Franchise Association of New Zealand (FANZ), 13
Franchise Association of South Africa (FASA), 14
Franchise Council of Australia (FCA), 10
franchisees, 3-4
Franchising and Licensing Association (FLA), 13
franchisors, 3-4
Fredsted, Inger, 10
French Franchise Federation (FFF), 11
Frohlich, Dieter, 11
The Funding Network (TFN), 136

G
GDP purchasing power parity per capita, 79
German Franchise Association (DFV), 11
Ghost, 66
Goddard, Mike, 11
Gras, Guy, 10
Greek Franchise Association, 11
Greenbury, Richard, 65
Group Rallye, 104
growth of franchising in U.S., 4
Guo Geping, 10

H
Hannah, Dan, 87-88, 94-96, 164
HFA (Hungarian Franchise Association), 12
Hijikata, Kiyoshi, 12
Hill, Jaclyn, 105
Hinduism, influence on Balinese way of life, 138
HKFA (Hong Kong Franchise Association), 11
Hong Kong Franchise Association (HKFA), 11
Hungarian Franchise Association (HFA), 12
Hussein Abou El Fath, 10

I
Idestrom, Jonas, 14
Illiadis, I., 11
income distribution for selected countries, 80-81
Indonesia
business environment, 133-134
Sari Organik Farm, 128-132, 176-181
  business environment, 133-134
corporate social responsibility (CSR), 132
  mission, 125-126
  reception of Sari Organik model, 139-140
  rice farming in Bali, 134-136
village system in Bali, 137-139

International environment, national franchise associations, 10
Italian Franchise Association (AIF), 12
Ivelj, Tanja, 23

J
Jackson, Betty, 66
Japanese Franchise Association (JFA), 12
Jaywant, Dhruv, 10
JFA (Japanese Franchise Association), 12
jobs from franchising in U.S., 4
Johnson, Anna, 75-76, 83-85
Johnson, Kyle H., 105

K
Kazakhstan Franchise Association, 12
KE. See Kodak Express
Kelian Subak (Bali), 138
KFA (Korean Franchise Association), 12
Kim, Min-Guk “MG,” 35-36, 156
Kimura, Tomoyuki, 10
Kodak Express, 77-85
  benefits to Kodak, 77
  calculating potential demand, 83-84
data availability, 78-82
  estimating demand in emerging markets, 75-76
global strategy, 76-77
  opportunities in emerging markets, 162-163
Korean Franchise Association (KFA), 12
Kukecs, Ljiljana, 10

L
Lamich, Ivo, 10
Lando, David, 104. See also The Athlete’s Foot, Inc.
Lando, Robert, 104. See also The Athlete’s Foot, Inc.
Lebanese Franchise Association (LFA), 12
Lee Min-Kyu, 39
LFA (Lebanese Franchise Association), 12
Lintas, 102
Logan, Estelle, 13

M
M&S. See Marks & Spencer
Malaysian Franchise Association (MFA), 12
Man, Kim Yung, 12
management, Marks & Spencer, 65-66
Mandel, Katalin, 10
market development model, Ruth’s Chris Steak House, 93
market environment, China, 111-112
market selection criteria, Ruth’s Chris Steak House, 92-94, 165-169
marketing at Marks & Spencer
  place, 55
  price, 54-55
  products, 53-54
  promotion, 55-56
Marks, Michael, 50. See also Marks & Spencer
Marks & Spencer
  business situation, 50-52
  company background, 49-50
  competition, 52
  corporate culture, 66
  financial snapshot, 51
  internationalization, 56-57
  The Americas, 59-61
  Europe, 61-62
  Far East, 61-62
  modes of entry, 57-58
  operating results and regional comparisons, 59-63
job cuts, 159
marketing
  place, 55
  price, 54-55
  products, 53-54
  promotion, 55-56
marketing philosophy, 49
overreliance on British market, 64-65
price cuts, 159-160
reorganization, 160-161
top management’s internal orientation, 65-66
Matulich, Chris, 89
McDonald’s, expansion into
  Croatia, 30
McLachlan, Lorraine, 10
meat consumption per capita, 94
Mees, Maarten Dorhout, 13
Mexican Franchise Association (MFA), 13
MFA (Malaysian Franchise Association), 12
MFA (Mexican Franchise Association), 13
microfranchising, 140-141
Mikhaylichenko, Yury, 10
Moataz Al Alfi, 10
modes of entry, Marks & Spencer, 57-58
Moran, Tom, 89
Moroccan Franchise Association (FMF), 13
Muranya, Laszlo, 12
N
national franchise associations, 9
Netherlands Franchise Association, 13
O
Oates, Keith, 65
Oosthuizen, Kobus, 14
Outback Steakhouse, 165
P
Pacek, Jasmina, 19-23, 147. See also San Francisco Coffee House (Croatia)
Pal, C. Yoginder, 12
Pavlin, Igor, 10
penetration model, Ruth’s Chris Steak House, 93
Per Una brand, 161
PFA (Philippines Franchise Association), 13
Philippines Franchise Association (PFA), 13
Pihlainen, Veli Pekka, 11
place, Marks & Spencer, 55
political environment in Croatia, 26
population of selected countries, 2010, 78
Portuguese Franchise Association (APF), 13
potential demand, calculating, 83-85
price, Marks & Spencer, 54-55
product development model, Ruth’s Chris Steak House, 93
products, Marks & Spencer, 53-54
promotion, Marks & Spencer, 55-56

R

Rainbow Mandala, 128
RARF (Russian Franchise Association), 13
regional analysis, Marks & Spencer internationalization, 59
The Americas, 59-61
Europe, 61-62
Far East, 62-63
RetailCo, Inc., 101-103
rice farming in Bali, 134-136
Russian Franchise Association (RARF), 13
Ruth’s Chris Steak House, 87-88
company background, 88-92
diversification model, 93
growth by decade, 90-92
market development model, 93
market selection criteria, 92-94, 165-169
opportunities for international growth, 94-96, 164-169
penetration model, 93
product development model, 93
political environment, 26
procedure for engaging franchises, 147-155
startup, 19-21
stimulating franchise development, 26-28
Santillan, Guido, 10
Sari Organik Farm, 128-132, 176-181
business environment, 133-134, 177-180
company background, 128-129
consolidated income statement for month endings April 30, 2010, 130-131
corporate social responsibility (CSR), 132
microfranchising, 140-141
mission, 125-126
reception of Sari Organik model, 139-140
rice farming in Bali, 134-136
village system in Bali, 137-139
Schwerla, Andreas, 9
Secades, Lucas, 9
Senang Hati (Happy Hearts), 128
SFA (Slovenian Franchise Association), 14
SFCH (San Francisco Coffee House)
barriers to franchise development, 28-30, 32
competition, 30-32
economic environment, 24-25
employees, 23
expected revenues and expenses, 33
financial performance, 23
opening of, 21-23
political environment, 26
startup, 19-21
stimulating franchise development, 26-28
SFF (Swedish Franchise Association), 14
SFV (Swiss Franchise Association), 14
Shanghai Fuller Foods Ltd., 102
Slovenian Franchise Association (SFA), 14
Smart, Brian, 10
Smith, Paul, 66

South Korea
  coffee shop franchises, 43
  barriers to franchise development, 42-43
  coffee prices, 42
  coffee shop brands, 40-41
  coffee shop culture, 39
  college market, 38
  economic environment, 37
  food available at major Korean coffee shops, 45-46
  loyalty cards, 41
  possibility of franchising major Korean coffee shops brands, 43-44
  opportunities for franchise development, 156-158

Spanbauer, Killian, 104
Spencer, Tom, 50. See also Marks & Spencer
SRI (System of Rice Intensification), 136
St. Michael, 54
Starbucks Coffee Korea, 39
Stegne, Milan, 14
stimulating franchise development in Croatia, 26-28
Subaks (Bali), 138
Svensson, Anders, 10
Swedish Franchise Association (SFF), 14
Swiss Franchise Association (SFV), 14
System of Rice Intensification (SRI), 136

T
Taiwan Franchise Association (TCFA), 14
Tammouni, George, 10
TCFA (Taiwan Franchise Association), 14
Tensek, Denis, 19-23, 147. See also San Francisco Coffee House (Croatia)
TFN (The Funding Network), 136
Tri Hita Karana philosophy, 138, 141
Trota, Robert F., 13
Turkish Franchise Association (UFRAD), 14

U
Ubad, Bali, 139-140
UFRAD (Turkish Franchise Association), 14
United States, Marks & Spencer entry into, 59-61
USDA Prime, 89

V
Valasis, Vera, 10
Vastamaki, Juha, 10
village system in Bali, 137-139

W
Walker’s, 59
Wang, Rick, 101-103, 106-108. See also The Athlete’s Foot, Inc.
Whitehead, Maureen, 58
Wildhaber, Christoph, 14
Wong, Terry, 10

X-Y-Z
Yanakakis, S., 10
Yudhoyono, Susilo Bambang, 133
Zakharov, Andrey, 12
Zimmer, Chantal, 10