**Special Focus**
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# Ins and outs of franchising

## OVERVIEW

Dr Chandroo: 'For newcomers in business, franchising can provide them valuable management assistance, including accounting procedures, personnel and facility management. Regional or national marketing done by the franchise brand benefits all franchisees. A franchisor also provides training for the franchisee. This is especially important if the concept is complex.'

FRANCHISING is known as a faster way to help a brand owner grow quickly, while giving novice entrepreneurs a shot at running a business with the support of an already established business model. But the approach also gives rise to its own set of risks and challenges. How can the franchisor-franchisee relationship be enhanced for a win-win situation?

**Panellists:**

- T Chandroo, Chairman, Franchising and Licensing Association
- Roger Tan, Executive Director, Ramen Ten Restaurant Pte Ltd
- Adrin Loi, Executive Chairman, Ya Kun International
- Bobby Ong, Managing Director, Autosaver Pte Ltd

**Moderator:**

- Chen Huifen, correspondent, The Business Times

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**Q: These days franchise fees don't come cheap. Given the high costs, is it still worthwhile to go for the franchise model, especially in Singapore where the entrepreneur wannabe also has to fork out another significant sum for the property to be used in the business?**

**Bobby Ong:** Franchise fee is inevitable. Without that, the franchise programme may lose its values. A good franchise programme or a good franchise brand can help to shorten the business learning curve. A well established franchisor would be able to assist the franchisee to minimise the business risk while maximising the business potential.

Despite high business costs in Singapore, in particular property, it is still viable to consider taking up a franchise business. Franchising offers a proven system which can be replicated so franchisees can readily start the operations in different territories. With franchising, new entrepreneurs will not need to start building their own track record as the franchise brand already has a proven track record for them to go to market quickly.

**Adrin Loi:** The brand may be a long-established brand which has taken years to build. Hence, the franchisee will acquire the goodwill of the brand upon owning the franchise and this definitely costs more than the high costs of the franchised fees and the property put together.

**T Chandroo:** If a budding entrepreneur strikes out on his own, he or she will be setting up an independent business based on both an untried idea and operation. Hence, the risks are greater. The experience of the franchisor's management team increases the potential for success. This experience is often conveyed through formal instruction and on-the-job experience is often conveyed through formal instruction and on-the-job training.

Franchisees can often buy lower-cost goods and supplies through the franchisor, resulting from the group purchasing power of all the franchises. Established franchise brands also offer national or regional name recognition and operational efficiency. Franchising provides a uniform system of operation, so that consumers receive uniform quality, efficiently and cost-effectively. For newcomers in business, franchising can provide them valuable management assistance, including accounting procedures, personnel and facility management.

Another benefit of franchising is marketing. Regional or national marketing done by the franchise brand benefits all franchisees. A franchisor also provides training for the franchisee. This is especially important if the concept is complex.

So, while the upfront cost of taking up a franchise may not be low for entrepreneur wannabes, franchising allows them to hit the ground running without having to reinvent the wheel or grind through years of perfecting that solution or recipe.

**Roger Tan:** Granted that franchise fees don't come cheap, we must qualify that, from observation, franchise fees offered by franchisors in Singapore - especially those in the F&B sector - have not significantly increased compared to, say, 10 years ago.

**Q: What are the questions that potential franchisees should ask franchise owners?**

**Dr Chandroo:** There are many questions that potential franchisees should ask before signing up a franchise agreement. They should find out the cost of the franchise, the cost of setting up each outlet, the track record and financial standing of the franchise owner, the success rate of the franchisees who have taken up the franchise, the expected timeframe for the business to break even and attain profitability, the types and levels of assistance that the franchise owner can give to the franchisee and what are the commitments that both the franchisor and franchisee have to be tied to in the franchise agreement. In addition, they should also ask about marketing support for the franchise and the level of competition in the business.

However, the franchisees should ask not just questions of the franchisor alone. They should also ask themselves some serious questions - on whether they have enough financial resources to take up and operate the franchise business over the long term, the various financial assistance options available to them and whether they have the passion to really drive the business forward.

They should also ask themselves if they are prepared for lifestyle changes, especially the first-time entrepreneurs who intend to run the business themselves. Running a business can mean long hours and taking multiple risks and hence it is not the same as performing a job as a paid employee with specified work scope and working hours.

**Mr Loi:** If they are risk averse, they should find out about the different kinds of related risks involved in owning a franchise. In addition, they should understand the consequences involved should the risk turn real.

**Q: And how should they (potential franchisees) evaluate the possible rates of return on the earnings of their new venture?**

**Dr Chandroo:** There is no fixed rate of return for franchise ventures. Unlike stock investments or investing in unit trusts, franchise businesses are not passive investments with typical return formulas. Virtually all franchises assume that the owner will be investing at least some of their time and talent in the business in addition to their money.

So an investment in a franchise should provide a return for both the money and the time that is being invested in the business; hence the complication in the ROI calculations for franchise businesses. As such - one can reasonably assume that the rate of return from a franchise business should be higher than that of a passive investment given the fact that you need to invest time and effort to operate and sustain the business.

**Mr Loi:** Perhaps they should also find out about the demands of the nature the business. When evaluating the possible rates of return, a market study should be done to better understand the demographics and spending power of their target customers. This allows for a more accurate gauge of sales figures. Estimated numbers should be fair and should not reflect over- or under-confidence.

**Mr Tan:** The potential franchisee should develop his or her own financial model of the new venture with relevant inputs from the franchisor. This will provide an indication of the likely capital investment and the rate of return.

**Q: Just to temper expectations, on average, how long does it typically take for a franchisee to achieve profitability?**

**Mr Ong:** Business profitability can never be easy to accomplish in the short term. Profit is subject to operating cost as well as cost of materials. For Autosaver, I would say that franchisees can achieve profit in three months. A prolonged period of losses can be a big strain on franchisees.

To help franchisees along, the franchisor can support their franchisee by delaying collection of royalty fees from their franchisees for some months until they become profitable.

**Mr Tan:** There is no 'magic answer' to this though in the F&B business, one certainly hopes to see profitability as soon as viable - it can be any where between six months to even 24 months of commencement of the business. Naturally, the more investments, the longer the period needed.

**Mr Loi:** Profitability depends on many factors such as consumer traffic, consumer tastes and preferences, cost control, etc. While some factors can be negated with marketing promotions or better work processes, others may be inevitable. On average, it takes a year and a half to start seeing profitability.

**Q: While the franchising approach has its merits, we know it's not going to be a bed of roses all the time. We've heard of franchises that fell apart, with either the franchisee pulling out prematurely or the franchisor having to buy out the franchisee. In your opinion, why do franchises fail? And how can failures be avoided?**

**Mr Loi:** In most instances, franchises fail due to the lack of communication between franchisor and franchisee in the area of expectations of each party. As such, relations are strained and both parties are not working towards similar goals. This results in the breakdown of the franchise system.

To avoid this, details of each party's expectations should be properly communicated and quantified. This provides directions to the decisions and actions of both parties.

**Mr Ong:** The franchise relationship between the franchisor and franchisee is always the main key component in a franchise programme. There are many different set of issues, for instance, managing and maintaining the franchise brand can unfold when working with the franchisee. Many times, franchise programmes fail due to lack of understanding and miscommunication from both parties.

My strong advice is for both the franchisor and franchisee to communicate regularly. It is important to understand the whole package, both the advantages and the challenges that come with franchising. The franchisor needs to be patient, truthful and informative while the franchisee should stay sensible towards changes. A franchise council is needed if the franchise chain is big. The council can be chaired by a franchisee for each meeting.

The objective of the franchise council is to moderate issues and differences between franchisor and franchisees. It is important that the franchise owner remains competitive and at the same time flexible and adaptable to market changes and demands. My franchise philosophy is that 'the franchisee must make money'.

**Dr Chandroo:** Many new franchisees fail to plan their financials accordingly. Franchise businesses take time to become profitable - so franchisees must have the financial resources and support to ensure that they can run their business over time before the businesses realise a profit.

Franchises will also suffer if the market is already saturated and competition very stiff in that business sector. Although franchisors typically guarantee their franchisees territorial exclusivity, small territories with intense competition can kill a budding franchise.

**Q: Finally, what's your outlook on the franchise industry in Singapore?**

**Mr Loi:** The playing field in Singapore is increasingly becoming more competitive. Hence, some may find nurturing a brand from scratch too time consuming and risky. As Singaporeans become more affluent, many may want to start their own businesses.

Owning a franchise would be less risky than starting a new business, since most franchises have established proven business models. Hence, many may wish to acquire franchises rather than start their own business. On the other hand, businesses may see a rise in applications for franchises and therefore put in place a more stringent criterion in their franchisee selection process. The synergy of these occurrences will result in better franchisees and franchise systems.

**Dr Chandroo:** The Singapore franchise sector has grown by leaps and bounds over the years. It has today in excess of 500 franchise systems, with more than 3,000 franchisees. We are optimistic that the outlook for the franchising and licensing industry here will continue to be promising. The annual turnover for the franchise sector is about $8 billion and makes up about 18 per cent of the total domestic retail sales volume.

In fact, vibrant growth of the franchising and licensing industry here has led to the rise of a thriving support industry, comprising franchise-related technology companies, law firms, and consultancies companies.

With Singapore's current system of supporting services including strong intellectual property infrastructure, established legal ecosystem and franchise capability development initiatives led by Singapore's Franchising and Licensing Association (FLA), I am confident that the franchising industry will grow and expand even further.

The FLA is taking definitive steps to provide support services and advice to members as well as non-members in the franchise fraternity in Singapore. We have organised seminars, talks, overseas business mission and a host of other activities to promote the industry. We intend to continue to develop new initiatives to further the success of franchising in Singapore and to establish Singapore's strong brand name as a key franchise hub in Asia.

**Mr Tan:** Our optimistic outlook on the franchise industry for Singapore is not just limited to the local level. We are also very confident about international franchise opportunities, which are springing up rapidly in different industries, depending on which industry you are involved in. We had inked a major deal with a company in the Middle East, who will be opening franchise outlets for us in the Middle East and North Africa. Such an international franchise deal is the first of its kind in Singapore, and is an example of opportunities for Singapore franchises to tap into niche markets for expansion in other parts of the world.



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