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Franchising, a necessary shift in development trends

Karim Asmar, managing partner at HODEMA hospitality development, looks at the talent at the base of a successful franchise development

Franchising is an Eldorado. Just like in the time of the gold rush, when aspiring miners raced to Alaska and other gold rich areas, restaurateurs and entrepreneurs in the Middle East are now rushing to develop franchises with the aim of selling them to the highest bidder. Concept operators and developers are multiplying their commercialization efforts to sign the golden deal that will extend their coverage across the region while bringing them the much sought after stream of fees.

Over the last decade, there has been an increase in demand for franchising products. This has been driven by real estate development, as well as the financial hypes, which extended the interest of Real Estate Investment Trusts (REITs) on the hospitality industry and, more specifically, the food and beverage industry. Indeed, with the development of shopping malls in the region it was necessary to instate a diversified F&B activity that is vital for the sustainable development of a retail activity.

Increasing demand

To that effect, it is no surprise to observe that the largest F&B brand operators are themselves mall developers and owners. For example, the Kuwaiti based group Al Shaya runs brands such as Starbucks and Le pain quotidien, along retail brands such as Next, The Body Shop and Solaris with significant ownership and management of malls in the region.

Despite the crisis, demand for franchises is still increasing in the region; however the source of the supply has changed. The regional market has proven dynamic and creative. Original brands and concepts have been emerging across the region. Saudi based Kudu announced an impressive 187 units as of November 2009 in 7 countries across the region. On the other hand, Al Tazaj is now running at 62 units in KSA and has reaches in Egypt, UAE and Malaysia. Semsom signed a master franchise agreement for the development in KSA. Casper and Gambini's already has a presence in KSA, UAE, Qatar, Kuwait, Jordan and Egypt. The Lebanese based Italian coffee shop Moka and More, has also developed in Syria, Egypt and other Middle East countries.

Look for loopholes

Often, operators embark on a venture while still unprepared. With a flailing operation, insufficient allocation of resources or lack of screening on their potential franchisee, many developers/operators have been deceived by their franchising experiences.

On the other hand, franchisees, have been also attracted by the hype surrounding some concepts, as well as driven by the real estate development. In search of a success story of their own, many franchisees have ventured unprepared or unwary of the requirements of the industry or the franchising process.

Franchising is a process that contains many loopholes. Both franchisor and franchisee have to identify and focus on convergent interests. Far too often, while the focus remains from both sides on the fees, other value adding elements are blatantly neglected, leading to a series of frustrations from both sides.

Franchise development common strategic challenges

- Concept definition, clarifying the concept
- Identifying the right unique selling proposition of the product
- Learning the franchising business
- Development strategy of the franchise
- Definition of the franchisee profile
- Screening of the potential franchisee
- Maintaining the franchise independent from the operation
- Managing the copy cat effect and maintain product differentiation
- Transfer of technology and know how, loosing exclusivity of the product
- Branding and brand management
- Managing and growing talent
- Availability of the supplies in the targeted market
- Availability of the required technical resources in the targeted market
- Legal frameworks and intellectual property protection
- Identification of key strategic locations for the outlets
- Securing key strategic locations in the long run
- Management of the neighborhood competition
- Securing the financing for the development of the franchise
- Sustaining the operation without cash support from the franchise

Case study 1: The unprepared franchisor

Youssef runs an oriental baked specialties operation. He created his own original concept; he has a central kitchen in the northern suburb of the capital and runs 2 outlets. This is not sufficient to sustain the high fixed costs of the central kitchen. His products, though typical, have original recipes and he considers them his competitive edge in a market dominated by automated bakeries. With a technical background, he is involved in every aspect of operating his central kitchen. His outlets are relatively well located in the capital, but he recently had to shut down one of them due to high rent. The outlet was not yielding sufficient revenue despite its prime location.

Youssef started his project with an objective to keep it a family business. In fact, he turned down several requests for partnership from friends and investors. While he initially planned to have multiple operations, he found that it was complicated and that it required more than quality backed products to sustain activity. He identified franchising as a potential source of cash and income. Ideally, he would identify a franchisee from another country, sell his franchise and collect the much-needed cash. Youssef failed to consider that while his recipes are unique and his products have a unique taste, they are easily substitutable. With no clear system and development strategy and turnkey solution proposed, Youssef stood little chance in front of shrewd businessmen. Rather than buy his franchise, a Gulf based investor attempted to replicate the concept.

Regional trends

Franchisors in the region tend to focus on identifying master franchises rather than outlet franchises. The master franchisee are not necessarily hands on specialists and will look for hiring talent to run their units. Frequently, franchising comes as a necessity to inject cash into an operation. Stories of agreement signatures for regionally developed concepts with amounts reaching and exceeding the million US dollars mark are there to comfort the myth.

In seeking a larger franchisee, regional franchise developers hope on one hand to reduce stress on their operation by transferring the outlet operation support obligations to a master franchisor who will build a large team, and on the other hand the higher franchising fees potential to attract them. Financial groups with diversified investments and a strong real estate component to have a better reach at securing prime locations for the development of the franchise. Indeed an essential component in franchise development is the real estate. However, it is not the only one.

Case study 2: The aspiring franchisee

Francois is a French restaurateur successfully operating a large pizzeria franchise in the periphery of Tours, a city on the shores of the Loire in France. Like many franchisees in the West, he is a hands-on operation man involved in all aspects of his operations. From cashiering to purchasing to service to human resources management, he is around and follows up on it.

He started his career in the food and beverage department of a London luxury hotel and then pursued his career in various luxury hotels across Europe. Coming back to France he occupied general management positions in 2 hotels and resorts.

When he decided to become an entrepreneur, he did not foresee himself as a pizza restaurant operator. Still having decided to go on a venture he assessed various options and finally identified an opportunity to buy an existing franchised operation whose owner wanted to retire. After a careful audit of the operation, he elaborated his takeover business plan, and within two weeks, had his approval for financing from a local bank.

At that time, he had been in discussion with the franchising brand group for more than a month. Eventually it took him around four months before being co-opted by the group as the potential franchisee for this operation.

Actors strategic scope in franchising process

• Brand management	• Franchisor, brand owner
• Product development	• Franchisor, brand owner
• Operation support	• Master franchisee
• Outlet operation	• Franchisee

The right talent

Significantly enough, the lengthy process was not focused on the discussion of the contract, or the negotiation of the fees. The group's focus was on: how would this candidate contribute positively to the brand and its value. After obtaining the group's approval, Francois couldn't believe that the banks went easier on him than the franchisor did in scrutinizing every aspect of his experience, management style, motivation and so forth. They were keen to insure he had the right talent and that he fit the company culture.

In the Middle East, operators in the hospitality industry are struggling to secure talent for their operations. Like many operators Youssef also struggled with human resources. Two key persons recently left him, one recruited by a large group developing several franchises in Qatar; the second wanted to start a restaurant on his own.

Keeping talent has proven difficult for operators. Often employees are lured by higher salaries through expatriation, or feel the need to become entrepreneurs. Having acquired a knowhow they can easily duplicate a similar product.

Franchisors have proven weak at internally promoting their franchise or developing a succession plan leading to ownership of a franchised outlet. While operators identify talent to run their operation, rarely does such talent become a franchisee or a partner.

Case study 3: The franchisee from the inside

Chafic is a taxi driver in Beirut. At 27 he recently came back to Lebanon after completing 3 years in a Gulf country and realizing he wanted to be nearer to his girlfriend and get married. Upon his return, he joined one of the local taxi offices that operate around 50 cars. Chafic was ambitious and wanted to take a franchise taxi office and start a dispatch in the northern part of Lebanon. With the Kafalat loan facility (loans for small businesses) he should be able to secure the financing to launch the office. It is unusual that Chafic is seeking to franchise an existing taxi office rather than start his own. He hopes that with the use of a proven renowned brand, his profile will be improved at the bank when requesting a loan. In addition, he hopes to build on the contact database of the current office to jump-start his operation.

Brand equity adds value

Franchises are developing, and large investors have an increasing number of possibilities to choose from. For operators, developing their franchise activity is often the means to secure quick cash and capitalize on their development efforts. While the fees are an essential value generator in the franchise, more added value comes from the brand equity. Brand equity is obtained by the expansion and the development of the brand. This requires a cohesive development plan based on the right product, the allocation of the right resources, and the identification of the right partners, securing locations and securing the talent. There is no better partner than the one that understands the company culture. Those who grow inside it best understand the company culture. With the scarcity of talent in the region franchisors should review their franchise development strategy. A rightful change would be to give Chafic the franchise to operate the taxi office.

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