



FRANCHISING ROMANIA: ORGANISATIONAL STRUCTURE AND INVESTMENT DESIGN

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Abstract

This document presents a brief review of franchisors in Romania. Using detailed data for the year 2007 provided by the CEBR and IMO Franchising, I examine the main characteristics of these businesses as well as their main differences in terms of contractual agreements and investments. I find that Romanian firms start franchising relatively quick (3 years after their start-up) and they mainly adopt simple franchise agreements. Conversely, lack of knowledge about Romanian market conditions makes foreign franchisors to operate under the master franchisors format. In addition, foreign franchisors request higher amounts of initial investment and they charge higher advertising fees.

Keywords: Franchising, Romania.

1. Introduction

Franchisors have first penetrated the Iron Curtin with a long list of industries including retail, service providers and restaurants in the early 90s.

Nowadays, franchising can be considered as one of the key ingredients required for transition countries to consolidate their sprouting market economies. In the specific context of Romania, franchisors entered the market soon after the breakdown of the centrally planned system (Revolution of 1989). Since then the franchise market has shown an upward trend, and whereas for 2004 the total number of franchises operating in Romanian was nearly 180, this number stood at nearly 250 in 2007.

The exports of business technology to the emerging markets using the franchise system creates new jobs, good management examples, economic development and strong business relationships.

The franchising format gives rise to a special type of entrepreneurial activity which differs from conventional entrepreneurship. Franchising entrepreneurs are able to step into a ready-made business model that has specific condition and yet are able to act independently within a local market (Sundbo, et al., 2001).



Franchising relationships are governed by a contract of two parties: a franchisor who owns a business, and a franchisee who undertakes to exploit a market opportunity by following operating procedures of the franchised business (Meredith, 1994).

In terms of control rights, franchising is asymmetric in terms of power since the franchisor controls and regulates the relationship.

Having invested his/her own money, the franchisee is not independent, that is, he/she is called to either accept the given conditions by the franchisor, or actively modify them to adapt his/her business to the conditions exhibited by the local market.

In this vertically integrated system, support from the franchisor is a key factor to favour knowledge transferability to the franchisee and improve the parental company's business.

Based on this, I aim to provide a description of the Romanian franchising market. Using detailed data provided by the Centre for Entrepreneurship &

Business Research (CEBR) and IMO Franchising, I attempt to increase the understanding about the main features exhibited by Romanian and foreign franchisors operating in Romania.

2. Data

2.1 Data from the Centre for Entrepreneurship and Business Research (CEBR) and IMO Franchising

The main data source to carry out this study was jointly created by the Romanian Centre for Entrepreneurship and Business Research (CEBR) and IMO Franchising for the 2007.

The CEBR is an organisation that promotes and develops research in the fields of entrepreneurship and business economics in Romania.

For more than 12 years, IMO Franchising has been the pioneer of franchise consultancy in Romania. Nowadays, IMO is the Romanian leader of sold franchises (52 in 2007), and the company has also worked on reports on franchising for the US Government and European agencies.



The database provided by the CEBR and IMO Franchising comprises information for more than 240 franchising companies operating in Romania. An important characteristic of the data from the CEBR and IMO Franchising lies on the consideration of Romanian and foreign franchisors, a fact that permits us study trends in franchising, as well as to examine those differential characteristics exhibited by local and foreign franchisors. Nevertheless, information availability is dissimilar which represents the main weakness of this dataset.

Table 1 presents the country of origin of franchises operating in Romania, whereas the industry configuration of these businesses in Romania in 2007 is presented in Table 2.

From Table 1 it can be observed that for those franchises in our sample which home-base is in the European Union, firms from Italy and France represent more than 15% of the total number of franchises operating in Romania in 2007.

Table 1. Geographical origin: Franchises operating in Romania in 2007.

<i>Country of origin</i>	<i>Number of franchises</i>	<i>Relative weight</i>
Romania	72	44.44%
EU Countries	59	36.42%
Italy	13	8.02%
France	12	7.41%
Spain	7	4.32%
UK	5	3.09%
Hungary	4	2.47%
Germany	4	2.47%
Portugal	4	2.47%
Greece	3	1.85%
Belgium	2	1.23%
Denmark	2	1.23%
Ireland	1	0.62%
Sweden	1	0.62%
Austria	1	0.62%
Other Countries	31	19.14%
USA	20	12.35%
Canada	4	2.47%
Australia	4	2.47%
Israel	1	0.62%
Argentina	1	0.62%
Turkey	1	0.62%

Italian franchises in our sample mainly operate in the apparel and accessories sector (6 franchises), whereas French businesses are located in the retail (4) and corporate services (3) sectors.



To the contrary, from the sample I only report one franchise from Ireland (ECDL since 2002), Sweden (IKEA since 2007) and Austria (Volksbank since 2005).

As expected, I find a significant number of US franchisors (12.35%) operating in very diverse industries: fast food (6 franchises), personal services (3 franchises), corporate services (3 franchises), real estate (2 franchises), hotels (2 franchises), retail (2 franchises), and restaurants and apparel and accessories (1 franchise).

Concerning Romanian franchisors, I find that, for 2007, nearly 45% of the total franchises operating in Romania are local (Table 1).

More than 55% of Romanian franchises operate in the personal services (25) and retail (15) sectors. On the other hand, I report no franchises operating in the real estate and hotel sectors (Table 2).

Concerning the industry distribution of franchises operating in Romania, I observe that, in the sample, the highest proportion of franchises operate in the

Personal Services sector (24.84%) (Table 2).

For 2007, Personal Services concentrates nearly 25% of the total number of franchises operating in Romania

In addition, I report significant representation of franchises in the retail (26 franchises), apparel and accessories (22 franchises) and corporate services (20 franchises) sectors.

To the contrary, the lowest proportion of franchises is reported in the real estate (2.48%), food (2.48%) and construction sectors (1.86%).

Interestingly, 19 out of the 22 businesses operating in the apparel and accessories sector correspond to foreign franchises. Similar results are reported in the fast food and corporate services sectors.

A more balanced distribution of Romanian and foreign franchises is reported in the personal services, retail and restaurants and coffee shops activities.



Table 2. Sample Configuration: Romanian and Foreign Franchises operating in Romania by Activity Sector

Sector	<i>Total Sample</i>		<i>Romanian Franchises</i>		Foreign Franchises	
	<i>Number of franchises</i>	<i>Proportion of franchises</i>	<i>Number of franchises</i>	<i>Proportion of franchises</i>	<i>Number of franchises</i>	<i>Proportion of franchises</i>
Apparel & Accessories	22	13.66%	3	4.17%	19	21.35%
Construction	3	1.86%	1	1.39%	2	2.25%
Corporate services	20	12.42%	7	9.72%	13	14.61%
Fast food	19	11.80%	7	9.72%	12	13.48%
Food	4	2.48%	3	4.17%	1	1.12%
Home equipment	12	7.45%	7	9.72%	5	5.62%
Hotels	2	1.24%	0	0.00%	2	2.25%
Personal services	40	24.84%	25	34.72%	15	16.85%
Real estate	4	2.48%	0	0.00%	4	4.49%
Restaurants & coffee shops	9	5.59%	4	5.56%	5	5.62%
Retail	26	16.15%	15	20.83%	11	12.36%
Total Franchises	161		72		89	



3. Results

3.1 Main Features

In this section I present some results concerning the main characteristics of franchises operating in Romania.

First, and concerning business age, results in Table 3 indicate that Romanian franchisors in this sample are relatively new franchising, whereas international ones have extensive experience. However, in terms of time operating in Romania, I find no differences between local and foreign franchisors.

Romanian firms start franchising 3 years after their start-up.

As regard Romanian franchises in the sample, I observe that, on average, these firms started franchising relatively quick after their first year of operation (3 years).

This behaviour is in accordance with Brickley, et al. (2006) who remark that newly created firms are less certain about the real value and optimal design of their franchise contracts. In addition, these firms might see franchising as an opportunity to expand their business in a more regulated fashion, and where they exert control rights on their new local units.

This could also signal the presence of a learning process where these firms, before to start franchising, accumulate information and experience about internal operations and from the market (information asymmetries). Hence, business experience facilitates the future structure of the franchise.

Table 3. Business Age: Romanian and Foreign Franchises

	<i>Romanian Franchises</i>	<i>N</i>	<i>Foreign Franchises</i>	<i>N</i>	<i>Overall</i>	<i>N</i>
Total business age	6.84 ^{***}	19	30.78	23	19.95	42
Years franchising in Romania	3.89	61	3.12	76	3.46	137

N refers to the number of observations. *, **, *** indicates significance at the 0.10, 0.05 and 0.01, respectively (Kruskal-Wallis test).



Concerning the organisational structure, firms that decide to get involved in franchising usually adopt one of the following types of agreements: simple or master franchise. The former represents the typical franchising relationship, where a franchisee buys the right to process and/or sell specific products or services within a specific market. In the case of the latter, the firm decides to allow individuals or other firms to buy the right to sub-franchise a explicit business activity within a specific territory.

Table 4 shows that, in this sample, nearly 88% of Romanian franchises in the sample adopt the simple franchise approach to business. This is not surprising considering that local franchises have the necessary knowledge about the Romanian market (its main characteristics and mechanisms), a fact that prevents these

firms to offer master franchise agreements.

To the contrary, nearly 71% of foreign franchises operate in Romania under the master franchise format. In this case, and following my previous comment, this could indicate that foreign businesses prefer this type of agreement (master) because they lack the knowledge about the Romanian economic conditions as well as the skills to manage several business units in this market.

Nearly 71% of foreign franchises operate in Romania as master franchises, whereas 88% of Romanian franchises adopt the simple franchise format.

Table 4. Organisational Structure: Type of Agreement adopted by Romanian and Foreign Franchises

	<i>Romanian Franchises</i>	<i>N</i>	<i>Foreign Franchises</i>	<i>N</i>	<i>Overall</i>	<i>N</i>
Master Franchise	12.24% ***	49	70.83%	72	47.11%	121
Simple Franchise	87.76% ***	49	27.77%	72	52.07%	121
Others (Licensing)	0.00%	49	1.40%	72	0.82%	121

N refers to the number of observations. *, **, *** indicates significance at the 0.10, 0.05 and 0.01, respectively (Kruskal-Wallis test).



Results in Table 5 indicate the number of locals reported by those franchises with at least one active local unit operating in Romania in 2007.

My findings indicate that for both Romanian and foreign businesses, franchises have nearly 20 local units operating in Romania.

The apparent homogeneity in the number of local units showed by franchisors leads me to present a description of the distribution of franchises operating in Romania.

In the case of Romanian franchisors, I only identify 3 businesses (all in the retail sector) with more than 100 local units: Rodipet (243), Euro GSM (130) and Romstal (107). On the other hand, 39 Romanian franchises (66%) have less than 10 local units (Table 5).

Concerning the number of local units in foreign franchisors, it widely varies between 1 and 500. Whereas nearly 79% of these franchises report less than 10 local units, only 5 franchises have more than 50 local units: Mc Donald's (51), Volksbank (60), Alloys Dallmayr (100), ECDL (400) and Fornetti (500).

Table 5. Number of Local Units reported by Romanian and Foreign Franchises

	<i>Romanian Franchises</i>	<i>N</i>	<i>Foreign Franchises</i>	<i>N</i>	<i>Overall</i>	<i>N</i>
Local Units (Mean)	19.68	59	19.48	75	19.57	134
Years operating in Romania						
For Franchises with less than 5 years	18.53	43	12.71	56	15.26	99
For Franchises between 5 and 10 years	19.63 *	8	59.09	11	42.47	19
For Franchises between 11 and 20 years	29.14	7	25.33	3	28.00	10
For Franchises with more than 20 years	1	1	4.60	5	4.00	6

N refers to the number of observations. The number of observations changes due to the presence of some missing values. *, **, *** indicates significance at the 0.10, 0.05 and 0.01, respectively (Kruskal-Wallis test).



3.2 Initial Investment

At this point, an important question rising is whether Romanian and foreign franchisors show common paths in what concerns the structure of the initial investment.

From Table 6, it can be seen that foreign franchisors in this sample require significantly higher initial investments. For Romanian franchises, franchisees are required to make an up-front investment of nearly €73,000,

and of approximately €472,000 in the case the franchisee buys a foreign franchise.

Significant differences between Romanian and foreign franchises are also found in the entrance fee charged to the franchisee, fittings and equipment & fittings (Table 6).

Romanian franchises request a lower initial investment and lower entrance fees than their foreign counterparts.

Table 6. Initial Investment: Romanian and Foreign Franchises (Euros)

	<i>Romanian Franchises</i>	<i>N</i>	<i>Foreign Franchises</i>	<i>N</i>	<i>Overall</i>	<i>N</i>
1. Entrance Fee	5,389.40 ***	52	24,741.91	63	15,991.21	115
2. Equipment	27,480.00	5	19,833.33	3	24,612.50	8
3. Fittings	11,720.00 **	10	33,071.43	7	20,511.76	17
4. Equipment & Fittings	37,216.81 **	27	120,085.70	35	83,997.65	62
5. Inventory	65,000.00	2	50,000.00	1	60,000.00	3
6. Royalty						
Euro	1,220.00 **	5	425.08	6	786.41	11
Proportion of Sales	3.74%	37	3.86%	49	3.81%	86
7. Advertising Fee						
Euro	282.50 **	4	1,851.77	9	1,368.92	13
Proportion of Sales	1.00%	43	0.90%	46	0.95%	89
Total Investment	72,911.65 ***	54	471,718.10	79	309,796.70	133

N refers to the number of observations. The number of observations changes due to the presence of some missing values. *, **, *** indicates significance at the 0.10, 0.05 and 0.01, respectively (Kruskal-Wallis test).



Table 7. Initial Investment: Distribution of investment components in Romanian and Foreign Franchises

	<i>Romanian Franchises</i>	<i>N</i>	<i>Foreign Franchises</i>	<i>N</i>	<i>Overall</i>	<i>N</i>
1. Entrance Fee	0.2881 **	52	0.3962	63	0.3497	115
2. Equipment	0.6912 *	5	0.3060	3	0.5261	8
3. Fittings	0.4108 *	10	0.3081	7	0.3659	17
4. Equipment & Fittings	0.5161	27	0.5210	35	0.5188	62
5. Inventory	0.6125	2	0.4762	1	0.5671	3
6. Royalty	0.0184	5	0.0159	6	0.0171	11
7. Advertising Fee	0.0206	4	0.0551	9	0.0445	13

N refers to the number of observations. The number of observations changes due to the presence of some missing values. *, **, *** indicates significance at the 0.10, 0.05 and 0.01, respectively (Kruskal-Wallis test).

Regarding the distribution of the initial investment, it can be seen that for those franchises that include an entrance fee in the up-front investment, this component represents nearly 29% of the total initial investment for Romanian franchises, whereas for foreign franchises this rate stands at 39.62% (Table 7).

Also, Romanian franchises give greater importance to equipment (69%) and fittings (41%) when designing their initial investment, as compared to their foreign counterparts.

In what concerns the on-going fees, I find that the vast majority of Romanian and foreign franchises include a royalty and advertising fee based on total sales

(Table 6). The average royalty fee represents 3.81% of total sales (3.74% and 3.86% for Romanian and foreign franchises, respectively), whereas the mean advertising fee is nearly 1% of total sales for both local and foreign franchises. This result is similar to that found by Brickley, et al. (2006), who report for the US a mean royalty and advertising fees of 5.51% and 1.69% of total sales.

Finally, only 5 Romanian franchises in this sample do not report an incentive-based royalty, i.e., they charge a fixed annual royalty which is statistically higher than that shown by those foreign franchisors that operate in a similar fashion.



Conversely, the group of foreign franchisors charging a fixed advertising fee apply a statistically significant higher amount (€1,220) relative to that exhibited by Romanian franchises in the sample (€283).

4. Conclusions

Albeit the upward trend showed by franchising activities in Romania and Eastern Europe, little is known about the characteristics of local franchises. using a detailed dataset jointly created by the CEBR and IMO Franchising for 2007, I carry out a preliminary analysis of franchising in Romania, paying special attention to the main features showed by local and foreign franchises operating in this market.

I find that Romanian firms start franchising 3 years after their start-up, which suggests that these firms experience a learning process across firms before to expand in the local market through franchising.

This document provides evidence about the organizational structure adopted by franchises in Romania. Whereas the vast majority of Romanian franchisors offer simple franchise contracts, foreign companies franchise their businesses under the master franchise approach.

In addition, data available permit me to examine the design of the initial investment that the franchisee should face. On the one hand, local franchisors are mainly single franchises and they structure their initial investment similar to foreign ones: firm specific items are mainly focused on physical and human capital.

On the other hand, foreign franchisors value more entrance fees, whereas Romanian businesses pay more attention to investments on equipment and fittings.



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