

Franchising — Where It Fits In

Franchising and licensing share similarities but the former goes further and offers advantages.

BY HOWARD BELLIN*

Every franchise agreement is basically a license agreement. However, a franchise is a license agreement that has been sophisticated and embellished. Thus a franchisee gets a great deal more from his franchisor than the mere right to carry out a particular process or manufacture a particular product.

Even though a franchise is basically a license, franchising and licensing went their different ways many years ago. Franchising is at the same time an old and a new technique.

14 Some of the earliest forms of franchising date back to feudal times when English monarchs gave their nobles the right to levy and collect taxes. A portion of the taxes stayed with the noble. The balance went to the monarch. Each noble had his domain. In return for the right to levy taxes, the noble was expected to provide troops to the monarch in times of war.

Early commercial franchises grew up in England and the United States. Shortly after the American Civil War, the Singer Sewing Machine Company licensed peddlers in horse-drawn wagons to sell sewing machines in specific areas. In England, the breweries offered to raise the standard of public houses on the basis that publicans would take on a franchise to purchase and sell only the breweries' beer.

Early franchises were followed by such present day giants as General Motors and Coca-Cola. In each case, the companies secured distribution at the local level through businessmen who were well known in their communities and had sufficient capital to fund their business.

Franchising, throughout the world today is an enormous business. For example, in the United States, franchising accounts for 31% of retail sales and over 10% of Gross National Product. There are over 450,000 franchisees and 1,300 franchisors.

On a worldwide basis, franchising is growing rapidly. There is now significant representation of franchise companies in Japan, Australia, Canada, New Zealand, Mexico, England and several European countries.

The top 10 companies of *Fortune* magazine's list of the largest companies in the world are involved in

franchising. All of these companies are engaged in the automobile or oil industries.

Benefit

It would appear that licensors of scientific and technological techniques could benefit through adopting some of the methods and procedures used by franchising companies. Certainly, from my point of view, as a qualified engineer who is now heavily engaged in marketing, there appears to be a great deal more that licensors can do both to sell licenses and to assist their licensees to gain maximum benefit and generate maximum royalties from their licenses.

Many people engaged in licensing of technology think of franchising, if they think of it at all, as a hamburger or a piece of Kentucky Fried Chicken.

In fact, there is often a very high level of technology involved in franchising. People who are trained in the sciences or engineering, tend to think that transfer of technology only takes place as a result of the negotiation of complex licensing agreements between two organizations. They tend to think of the technology transferred as highly technical, complex and, in particular, engineering or science based.

When I went from engineering to marketing, I found that my training as an engineer was almost a hindrance in my development. When I began my career in marketing and franchising, I found that there was far more to the business scene than my narrow background allowed me to perceive. And, that there were many things that could happen in license arrangements that currently do not happen.

As background, we can use the ubiquitous and well-known McDonald's organization. Many franchise companies refer to their franchise agreements as license agreements, as does McDonald's. These agreements license franchisees to carry out the business of the licensor or franchisor in a particular manner. Thus, in the case of a McDonald's franchise, the franchisee is licensed to use McDonald's registered industrial property and trade secrets.

In a franchise, the franchisee normally pays an initial fee or franchise fee for the rights to the business and for the initial training and other assistance provided by the franchisor. The franchisee also usually pays an ongoing fee for the ongoing assistance provided by the franchisor.

The ongoing fee is referred to as a royalty or management service fee and is assessed as a percentage of turnover. As well, there is often an advertising levy assessed as a percentage of turnover.

The royalty or service fee is also a payment for the use of the franchisor's trade secrets.

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McDonald's trade secrets include methods of food preparation, waste control, staff rostering, sales procedures and even sophisticated accounting procedures.

The training of a McDonald's operator in McDonald's sophisticated techniques may involve, in its own way, as significant a transfer of technology as does an engineering process in, say, the oxygenation of steel. The technology is different but, not as complex, yet, complex in a different way.

The major difference between the McDonald's license and the typical engineering license is that an engineering license usually licenses the manufacture of a product or the carrying out of a process. But, after the scientific or engineering know-how is passed on, the licensor's obligations come to an end.

Contrary to this, in the McDonald's system, the franchisee is not only told how to prepare the food, he is also taught how to sell it, account for it and relate with his staff. Thus, he has an entire system and not a bare manufacturing license.

Is the difference significant? We have all heard any number of horror stories from licensors who have received virtually no return from their licenses. Of course, some licensors feel, nothing ventured, nothing gained. Since they didn't put up much money to sell the license they are only moderately concerned if they receive minimal income.

Obviously, the end result of any manufacturing process or any other business arrangement should be profit. In our society, there is adequate capacity and technology available to manufacture just about anything. The problem is to get the manufactured products to the consumer efficiently and economically. So, instead of selling a bare manufacturing license, licensors should look to selling, in addition, the technology of prospecting, selling and securing repeat orders.

In Australia, there is a company with the license to distribute high-pressure, water-blast equipment. The company developed a most sophisticated system of securing and developing leads. Its figures are so good that the principal needs a special graph to compare the company's performance with other licensees in the world. And, now the Australian operator will be franchising his special business technique throughout Australia.

Similarly, the licensor of a new packaging material should license, not only the manufacturing process, but also the promotional and distribution technique.

Such an approach would add profits to the operation of both licensor and licensee. Engineering and science needs to look outward. And, franchising is a viable addition or alternative tool to traditional licensing techniques.