

# AN OVERVIEW OF FRANCHISING IN THE HOSPITALITY INDUSTRY

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## ABSTRACT

*Nowadays, franchising is the most significant part in the hospitality industry through hotels and fast food restaurant. Franchisor gives the right to the franchisee to sell their product and service also to sub franchise it and worked under their brand name. Furthermore, in franchising there must be a contract between the franchisor and the franchisee which include the term and condition. Franchises include some aspects such as, screening, site selection, operating manuals and the pre opening. However, there are some advantages and disadvantages for both the franchisor and the franchisee. The expansion of franchise can be achieved through different strategies of distribution and the knowledge of the targeted market. The future of franchise can be gained through strategies of distribution system, which could emerge the entrepreneur into the majority economy and business.*

**Keyword:** *franchise, franchising, hospitality, retail, entrepreneur*

## ABSTRAK

*Saat ini, waralaba adalah bagian paling penting dalam industri perhotelan dengan hotel dan restoran cepat saji. Franchisor memberikan hak kepada franchisee untuk menjual produk dan layanan juga untuk sub franchise dan bekerja di bawah nama merek mereka. Selanjutnya, dalam waralaba harus ada kontrak antara franchisor dan franchisee yang meliputi jangka waktu dan kondisi. Waralaba meliputi beberapa aspek seperti, penyaringan, pemilihan lokasi, manual operasi dan pembukaan pra. Namun, ada beberapa keuntungan dan kerugian baik bagi franchisor dan franchisee. Perluasan waralaba dapat dicapai melalui strategi yang berbeda dari distribusi dan pengetahuan tentang pasar sasaran. Masa depan waralaba dapat diperoleh melalui strategi dari sistem distribusi, yang bisa muncul pengusaha mayoritas ke dalam ekonomi dan bisnis.*

**Kata kunci:** *waralaba, waralaba, perhotelan, ritel, pengusaha*

## **INTRODUCTION**

Franchising has been growing significantly fast in retail industry, as well as in the hospitality industry such as hotels and restaurants. Holiday inn, Hilton, Accor group, McDonald's, Kentucky Fried chicken, Pizza Hut are examples of companies that using franchising method. However, according to Felstead (1993), for the reason of being unaware of what franchise means, there are not many people who realise that franchising is being used in hotels and restaurants. This paper aims to explain the definition of franchising and using hotels and other hospitality operation and objectively explore on how franchising might be expanded and developed along with the advantages and disadvantages of franchising.

## **RESEARCH METHODS**

### **The Concept and Definition of Franchising**

The definitions of franchising given by the authors are almost the same. Nevertheless, Kotler et al (1996) and Spinelli et al (2004) noted that, franchising is a system of doing business by which the franchisor designs the marketing format by giving the right to franchisee to use its name, trademark or advertising, and to engage in selling, offering and distributing goods and services.

Franchising is considered as a preferred method of doing business throughout the global economy (Swartz 1994 in Hoffman and Preble, 2003). In the hotel industry, franchising was begun when the Ritz Development Company in New York City franchised the Ritz-Carlton. Walker (1999) stated that, it was the important development and growth strategy for the hotels and motels industry during the 1960s to 1980s.

According to Knowles (1999), mentioned that in franchise businesses, there must be a contract regarding all the terms and conditions agreed between the franchisor and the franchisee, the franchisee is obligated to make a large capital investment from their own resources, the territory within which the to operate will be given accordingly. The franchisor must maintain a continuing interest in supplying the franchises with support in all aspects of the operation of the business together with permission of format or procedure and the trade name along with the benefit goodwill owned by the franchisor.

There are three phases to franchise's business format, which are: a) business concept development, b) a continual process of assistance, c) a process of initiation to, and training in all aspects of the running of the business according to the concept (Davis and Lockwood, 1994). Furthermore, (Kotler et al, 1996) stated that, when the franchisee already had the right to use the name and methods of operation that comes with it, franchisee must pay a royalty fee and marketing fee depending on the brand equity of the franchise.

Keegan and Green (2003), explained that franchising is another variation of licensing strategy, specialize in product design and marketing, at the same time transferring responsibility to subcontractors. Additionally, franchising represent a powerful format with which to develop a global brand. Furthermore, Powers (1998) mentioned that a number of services that are especially important to the new franchisees, which includes screening, site selection, operating assistance, and pre opening training.

## **Screening**

A careful franchise selection is in the best interest not only of the company and other, existing franchisees but of the new franchisee as well. There are some points to be considered such as, the record of success, the potential franchisee's background and the financial position. In addition, some franchisors might even interview spouses to guarantee themselves of the family's commitment to the project if the prospective franchisee is expected to operate the new business (Powers, 1998).

## **Site Selection and Planning**

Commonly, companies select the site for the franchisee whereas the franchisors insist on the right to approve site, the physical layout of the operation; from the site plan to the building, equipment and furnishing will be described in detail (Powers, 1998).

## **Operating Manuals**

Operating manual represent the blueprint of the business format franchise and some contract state that its status is dominant over anything that is stated in the agreement (Barrow and Golzen, 1998). Additionally, Powers (1998) mentioned that operating manuals is the backbone of the operating system that covers from opening to closing and nearly everything in between. All major equipment operation and routine maintenance are mentioned in the operation manuals or in separate equipment manual.

## **Pre-opening Training**

Training is a very important part of the package, franchisee must know how much there will be and how long will it take, and to what extent training is compulsory or necessary. There are also some procedure for when things go wrong in addition to formal training and refresher courses (Barrow and Golzen, 1998). Powers (1998) added that the service ranges from McDonald's hamburger university and Holiday cooperation's holiday inn university, which are extensive management training units, to simpler programs based on experience in an existing store. The financial returns from the operation of a franchised business must be sufficient for the franchisee to earn a reasonable reward for his or her labors, and also to make payment to the franchisor of a reasonable fee for the services which he or she will continue supply to the franchise. Nonetheless, the franchisor must obtain a reasonable return on the assets employed in the business (Davis and Lockwood, 1994). Whilst Evan et al (2003) noted that in return for gaining access to the brand attributes, image marketing and other support from the franchisor, the franchisee usually takes a substantial portion of the financial risk (providing the capital investment) and pays to the franchisor.

According to Keiser (1999), franchisor usually demand continuing royalties that represent a certain percentage of the sales the typical franchising company receives continuing royalties of about 2 to 4 percent of the annual sales plus an advertising assessment of about 1 percent sales. Mendelsohn (2002) outlined that the convenience of franchise is between the two parties and the consumers benefit from the relationship. The franchising involved some characteristics: the allowance to the franchise to trade using format under the trademark of other from branding; the development by the franchisor which is operated under the trademark or other from branding; the franchisor must maintain a support to a franchisee to guarantee that the franchisee will taste the same or even bigger successful as the franchisor; the franchisee is needed to have an investment from their own resources; the franchisor must train the franchisee in all aspect of the business; the operation involved commitment and motivation and tend to make sure that the business has the maximum advantage, that the franchisee need to pay the franchisor for the service provided; the consumer must be benefited from a multiple network between franchisor and franchisee.

## **RESULTS AND DISCUSSION**

### **Franchising in The Hospitality Industry**

In the hotel industry, franchising began in 1907 when the Ritz Development Company in New York City franchises the Ritz-Carlton. From the 1960s to 1980s franchising, played a big role in the growth and development strategy of motels and hotels (Walker, 1999). Accordingly, Knowles (1999) noted that hotel franchising in the 1990s is becoming more competitive and complicated than in the 1950s and 1960s.

Furthermore, franchising had also seldom been used as a means to international expansion until the 1980s. Therefore, international hotel companies relied largely on leasing arrangements and management contracts. The investment risk associated with the internationalization of highly capital-intensive luxury hotels can be reduced by these methods (Connell, 1997 and Knowles, 1999). The international growth strategies of a number of hotel companies, they are: Holiday Inn Worldwide, Choice Hotels International, Sheraton and Radisson Hotels International. On the other hand, franchising characterizes two major challenges for the franchisor: avoidance of financial failure and maintenance of quality standards on the part of the franchisee (Knowles, 1999). Alternatively, Davis and Lockwood (1994) noted that the most important things for the franchisors are their willingness and ability to devote the financial and human resources.

Turkel (2001) declared that there are 65 percent franchised hotels all over the world. Where in Britain, about a third of hotels with eleven or more rooms are now part of big chain and mainly British owned. Additionally, Cooper et al (2000) illustrated that the group or chain element of the hotel sub sector accounts for between 5 percent and 10 percent of the property stock in most European countries which is significantly higher in South East Asia and in North America.

Moreover, Turkel (2002) stated that effective relationship between the franchised hotels and hotel franchisors are really partnerships-relationships that benefit both parties, which have a meaningful say considering the strategic direction the partnership takes. Increasing the mutual participation in the decision-making process resulting partners an expanded stake in the success of the relationship and encourages them to work harder and better to ensure that success.

Powers (1995) mentioned that almost half of the restaurant sales in the United States are made through franchised units. Half of the sales came from the specializing in hamburgers, which include 40 percent of franchise units.

For instance, McDonald's global expansion is made on franchising where the company has the business system that can be replicated in multiple country market and well-known brand (Keegan and Green, 2003). Hsu and Powers (2002) supported that McDonald's is the most aggressive food service company in international expansion. Furthermore, Kotler (2003) stated that in 2001 McDonald's was ranked it the top ten of the most valued brand name in the world which serve more than 46 million people each day in more than 100 countries.

### **Advantages and Disadvantages of Franchising**

Franchising might be the quickest way to own our own business; it relieved the businessman of the bother of serving an apprenticeship. Franchising allowed businessman to borrow and consequently trade on the expertise of the franchising company (Keiser, 1999). According to Kotler et al (1996) there was numbers of strengths in franchising for example; the smaller restaurant chain uses

the franchising method to help them to retain managers also allow the store to offer brand name products, and gain additional high traffic distributing points.

Keegan and Green (2003) added that by taking up franchise also provided some benefits, such as; specialized in product design and marketing, limited commitment of financial and quick entry to targeted countries especially when market is too small to justify considerable investment. Furthermore, Zeitami and Bitner (2003) concluded the benefit of franchising, consistency in outlets, knowledge of local markets and share financial risk, more working capital, and a leveraged business format for greater expansion and the revenues. However, there are some disadvantages such as; difficulties in maintaining and motivating franchisees, highly publicized disputes and conflict, inconsistent quality and control of customer relationship by intermediary. McDonald's, for instance, famous for the standards of the delivery service and monitoring performance. Naturally entrepreneurial by nature select franchise because they think can own and control their business, as a result, they more likely to feel like a machine with less freedom than they had in mutual jobs.

Further to this understanding, Felstead (1993) explained that the beliefs underlying about franchising is that both parties to the contract are approximately equal. However, franchisee does not bargain with the franchisor as an equal. As a matter of fact, franchisors are economically superior to the franchisee and without access to the franchisor's experience and trademark. The most obvious consequence to these circumstances is the dependent of franchisee to the franchisor. Licensees cannot break a contract without paying damages where franchisors are free to sell them out without their approval (Rowe, 1997). Franchisors are having a full control to its franchisees, for example, Marriot renegotiated its contract with Host Marriot Corp, another major owner of its hotels. As a result, Marriot will among other things, receive lower fees and give more control to Host Marriot to approving the budgets and other expenditures at the hotels (Binkley, 2002).

## CONCLUSION

It is clearly shown above that franchising is considered as the most important thing in the growth of hospitality industry. However, the term of franchising is quite confusing for some people, where it mentioned as the two ways of relationship between two parties one hand, and a name with different implication on the other hand. Despite the disagreement about the term, the future of franchise can be gained through strategies of distribution system which could emerge the entrepreneur into the majority economy and business.

The growth of franchising are influenced by many factors, some of them is because of the demand in the market is growing by the strength of the financial. Hall and Rob (1991) distinguished that there are four reasons for the growth of franchising, which are; role of service quality, value in place, motivation for self-employment and availability of finance. In Indonesia for example, franchising is considered as one of the most important growth strategies, the success of the strategies is by adapting the local taste into the product. For instance in Kentucky Fried Chicken, they serve rice and Indonesian soup, McDonald's serve burger with local curry taste. In the hotel industry as well, Hilton Hotel, Grand Hyatt, le Meridian is opening their franchise in Indonesia and really adapts the Indonesian Culture yet most of them are five star hotels.

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