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First published 2013 by
PALGRAVE MACMILLAN

Palgrave Macmillan in the UK is an imprint of Macmillan Publishers Limited, registered in England, company number 785998, of Houndmills, Basingstoke, Hampshire RG21 6XS.

Palgrave Macmillan in the US is a division of St Martin's Press LLC, 175 Fifth Avenue, New York, NY 10010.

Palgrave Macmillan is the global academic imprint of the above companies and has companies and representatives throughout the world.

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ISBN 978–0–230–36164–5

This book is printed on paper suitable for recycling and made from fully managed and sustained forest sources. Logging, pulping and manufacturing processes are expected to conform to the environmental regulations of the country of origin.

A catalogue record for this book is available from the British Library.

Library of Congress Cataloging-in-Publication Data

Webber, Robert, 1956?–

An introduction to franchising / by Robert Webber.
p. cm.

Includes bibliographical references and index.

ISBN 978-0-230-36164-5

1. Franchises (Retail trade) I. Title.

HF5429.23.W43 2013

658.8'708--dc23

2012036830

10 9 8 7 6 5 4 3 2 1
22 21 20 19 18 17 16 15 14 13

Printed and bound in Great Britain by
CPI Antony Rowe, Chippenham and Eastbourne

CONTENTS

	<i>list of figures</i>	x
	<i>list of case studies</i>	xi
	<i>acknowledgements</i>	xii
	<i>preface</i>	xiii
chapter 1	the origins and history of franchising	1
	franchising – the early years	2
	the brewing connection	4
	business format franchising	6
chapter 2	defining franchising	12
	the European definition	14
	the American definition	16
	the British adaptation	19
	the Australian definition	19
	an alternative definition	20
	understanding what can and cannot be franchised	24
chapter 3	the pros and cons of franchising	30
	advantages for the franchisor	30
	disadvantages for the franchisor	34
	advantages for the franchisee	36
	disadvantages for the franchisee	40
	advantages and disadvantages of home-based franchises	43
	advantages and disadvantages of well-known franchises	47
chapter 4	the franchise relationship	50
	negotiation	51
	innovation	53
	emotional turbulence	55
	stakeholders	59
	the secret of a good relationship	62
chapter 5	entrepreneurs and franchising	71
	women in franchising	78

chapter 6	the role of ethics in franchising	83
	guiding principles	84
	recruitment, advertising and disclosure	89
	selection of individual franchisees	94
	the franchise contract	96
	analysis of the other two codes of conduct	102
	social responsibility and franchising	105
chapter 7	cultivating a franchised business	110
	pre-launch	114
	post-launch	123
chapter 8	the steps to buying a franchise	135
	franchise development model	138
	types of franchises	141
	the six segments of franchising	144
chapter 9	legal and financial matters	159
	the franchise agreement	160
	description of the franchise and rights granted	166
	the term of the agreement	167
	the franchisor's obligations	168
	the franchisee's obligations	171
	dispute resolution	174
	termination of the agreement	176
	post-termination	178
	financial matters	182
chapter 10	developing the business	189
	expanding the franchisee's business	190
	developing a franchise overseas	194
	company expansion	199
	direct control model	200
	master franchising	201
	joint ventures	204
	co-branding	204
chapter 11	exit strategies	207
	running a lifestyle business	210
	selling the business	212
	dynastic succession	213
	closing the business	215
	the stock market flotation	220

chapter 12	developing the future of franchising	222
	the development of information technology	222
	stock control	225
	green franchising	229
	the future is all about change	236
	the future of the industry	237
	appendix 1: European Franchise Federation code of ethics	238
	appendix 2: the World Franchise Council's principles of ethics	243
	appendix 3: the International Franchise Association code of ethics	246
	appendix 4: national franchising associations	249
	<i>bibliography</i>	251
	<i>index</i>	259

1

THE ORIGINS AND HISTORY OF FRANCHISING

INTRODUCTION AND LEARNING OUTCOMES

The purpose of this chapter is to give the reader an understanding of the history of franchising, looking back to the origins of the word and discovering how franchising has developed into the business expansion system we have come to associate with the term in current usage.

The reader will be able to:

- Understand how franchising was conceived and how it has been modified.
- Understand the importance of the concept throughout history and its importance in today's business world.

Franchising is not a new concept! However, its origins are a matter of much debate and discussion. Some authors would have readers believe that it is a wholly American concept, devised in the mid-1800s to help American businesses establish an efficient distributor network. As we shall see over the next few pages, this notion does have some limited foundation and it was certainly the origins of business-format franchising, but the concept of franchising was undoubtedly in existence considerably earlier than when Christopher Columbus first set foot on the American continent!

The foundation of the franchising system probably lies closer to the Roman Empire as it existed in the early years of the New Testament than the commercial empires of businesses that have utilized this phenomenally successful business development model. Even the word franchise has its roots in the languages of central Europe, rather than the English language, though its precise origins are unclear.

FRANCHISING – THE EARLY YEARS

In ancient times, there was a Germanic tribe called the Franks, who derived their name from their weapon of choice – a spear. These Germanic warriors were given their name by their immediate neighbours, because this tribe was renowned for standing up for its rights in a vigorous manner (usually in battle, and using their trusty spears) so their name came to mean ‘free’ or ‘the defenders of freedom’, from which we get the phrase ‘to speak frankly, or freely’. The country name France comes from the same root, meaning the place where one can be free. Indeed, prior to the French Revolution, the currency of France was the *écu d’or* in Louis IX’s time (*écu* means ‘shield’, which featured on the coins, bearing a coat of arms, though it may be a reason why the French were firmly in favour of calling the currency currently called ‘the euro’, the European Currency Unit, or *ecu* for short), or the *Louis d’or*, which was first minted in 1640 during Louis XIII’s time. In 1795, having removed the aristocracy, the French Revolutionary Council introduced the silver decimal franc, meaning ‘free money’ or coinage minted after the freedom from the oppressive monarchy.

In the Middle Ages in England, the word franchise had come to be associated with citizenship and the freedoms that being a citizen brought, specifically the right to vote, and this is where the word disenfranchised enters the language, meaning those who have lost their citizenship rights, particularly the right to vote. Therefore, some would argue that, in deriving from the old French word ‘*franc*’, meaning ‘free’, we can assume that the original concept of franchising is the granting of certain rights to those who deserve (or can afford) a specific right to be granted, which in a positive sense is precisely what franchising does; the word franchise actually means freeness.

Nevertheless if one goes back to the early Roman Empire, where the *lingua franca* was Latin, there was the verb ‘*frango*’, meaning ‘to break into pieces’, and it may be that the roots of the word ‘franchise’ can be traced back to here.

Originally, when the legions of Rome colonized what has become known as the continent of Europe, the senate appointed a Governor to control the newly acquired settlement. The Governor had the responsibility of protecting the land and the people that inhabited it, to introduce Roman law, and to establish a level of governance that was intended to establish both freedom and a level of authority in the conquered land.

The cost of establishing a protectorate was to be met by the imposition of taxes, which were collected by the Governor from the inhabitants of the state. Any expenses were deducted from the taxes collected, including a percentage which the Governor retained as his remuneration, and the balance was sent to Rome to swell the Roman treasury. So we can see that

the Roman Empire was comprised of many semi-autonomous states, each holding allegiance to Rome, and controlled by an appointee of the Senate in Rome, whose task was to gather revenue (taxes) from the populace and after defraying costs of providing services (governance), would send the balance to the Rome.

When transposed over the business format model, we can see many similarities: the Roman Senate (franchisor) appoints a Governor (franchisee) to a dependent state (territory) where his task is to maximize potential and revenue and, after deducting his expenses, submit the balance to the Roman treasury (fees). Consequently, the concept of franchising potentially has its roots more in the task of collecting taxes than in any commercial enterprise, but the step forward to a mercantile arrangement was both simple and rational.

On a commercial footing, the Governors of Rome's far-flung dependent states quickly identified that sourcing all the needs for their local governance directly from Italy was both cumbersome and time-consuming, so they appointed local craftsmen and tradesmen to supply the needs of their administration – from chariots and weapons for the legions, to food and other provisions for their administration, each was sourced locally. The suppliers of these essential needs received their patronage from the Governor; they were licensed to supply their goods and services, and in return for their licences, they would pay the Governor a fee.

Using the previous analogy to interpret the actions of various parties, we can now see that, as well as holding the franchise from the Roman senate, the local Governor was now acting more in the role of franchisor in handing out licences to local tradesmen, and so we can also see where the concept of the master franchisee was born; that is, the franchisee who has the authority to issue licences to sub-franchisees.

This system of tax collection under franchise was so successful that it was adopted by most of the victorious powers down the ages. Certainly, when William the Conqueror arrived in England in 1066, he imposed a similar system of tax collection and created the role for local governors, though in William's administration, these were more localized, often being restricted to the area of a county or large city. William called his governors Sheriffs (coming from *scir* and *gerefa*, an ancient word for the royal authority in a shire) and we can therefore see that the much hated Sheriff of Nottingham from the Robin Hood fable was probably one of the first master franchisees in Britain!

One of the ancient rights bestowed by the Sheriff on the population was the privilege of holding fairs in the town, and many of these fairs still exist today (for example, the Nottingham Goose Fair). The fair was held on land owned by the state and controlled by the Sheriff, and in return the tradesmen who set up stalls at the fair paid a percentage of their takings to the Sheriff, often a tenth, or a tithe, as it was called.

The title of Sheriff still exists today as the representative of the monarch in some regions of England, but the role is now only a ceremonial title, as the role of tax collector has since devolved to central government, following the rule of Oliver Cromwell and the rise of Parliament. However, the concept of tithing continued. Gradually, the Church obtained more and more property and land, and those who worked on the Church estates were obliged to tender a tithe to the Church for God's bounty in giving them work. Naturally, the Church could not indulge in commercial activities, residing as it did on a far higher spiritual plane, but in order to meet its expenses, it had to raise capital and tithing was a legitimate route to fund-raising. Even today, in some religions, the expectancy of tithing still exists.

Moving away from matters religious and the funding of the Church, some would lay claim that franchising originated in the twelfth century with the ancient guilds of London. Certainly, there is evidence that a form of franchising was adopted by these august bodies, which would charge members an affiliation fee set by the guild and there would be a large fee payable for membership and annual payments to retain that membership. Some guilds charged a percentage of turnover as their fee, while others a set monetary amount. Membership of the guilds brought wealth and prosperity to the merchant classes – the name 'guild' comes from the ancient Anglo-Saxon word *gilden*, meaning 'to pay'.

THE BREWING CONNECTION

Moving forward to the early part of the nineteenth century, we find ourselves in the time when alcohol was starting to play an increasingly significant role in the lives of Britons and in other European states.

It has been suggested that business format franchising was originally conceived by the German brewer, Späten, who gave the rights to sell their beers to certain taverns, but the emergence of a single German brewer in this field alongside a number of British brewers who at the same time used this approach, might suggest that this form of franchising originated in Britain rather than in Germany, but there is little to support this hypothesis other than the quantity issue.

Wherever it started, at this time, the manufacture of ale was very much a more local affair than it is today; most hostleries made their own ale, and ale houses were spreading throughout the country. These ale houses brought with them other social problems and it soon became clear that some sort of regulation was needed. The government of the time decided that the taxation of ale manufacture would significantly reduce the number of ale houses, and consequently the inherent problems associated with them. Faced with financial ruin, however, the proprietors of these ale houses joined together and formed breweries, where the ale could be

brewed centrally and distributed to the ale houses that formed part of the brewing group. The landlords bought their ales from the brewer and in addition paid a tithe which covered the cost of the brewing tax. The brewer collected the tithes and dealt centrally with the tax-collecting arm of the treasury.

So we can see that, even at this late stage, relatively speaking, the franchise issued by the brewer was more concerned with the collection of taxes than being an ongoing commercial business, though the brewer derived its profit from the mark-up on the ale it was selling. The tithed houses soon became known as tied houses, and the term still exists today, where public houses are tied to a particular brewery, to which a percentage of the profits are paid.

The higher level of the franchising concept survives to this day – one will often hear it said that the government has awarded the franchise to do something to a particular company. In effect, charging a commercial operation for the right to carry out some task in exchange for revenue (or tax) paid to the Treasury. This notion is at odds with the definition of business format franchising, as we shall see, but within the general definition of franchising, and certainly within the guidelines of the original understanding of franchising, it is legitimate.

Readers will have noted that a qualification has just been introduced in respect of franchising to which they may be, as yet, unfamiliar. *Business format franchising* is the method of adapting the franchising model to the version to which most of us are accustomed and which we associate most frequently with the idiom 'franchising'. The history of franchising is summarized in Figure 1.1.

BUSINESS FORMAT FRANCHISING

It has never been entirely clear who was the originator of the business system that grew into business format franchising, but general consensus suggests that it happened in America and was either the founder of Singer Sewing Machines, Isaac Merritt Singer, or Cyrus Hall McCormick, the inspirational father of mechanical reaping and harvesting, as both systems appeared at about the same time, 1850–1, way before the American Civil War; but whichever got past the winning post first, both were instigators of a great tradition that has developed and changed the world of business in the following 160-odd years.

Looking at the case put by the founder of the Singer Sewing Machine Company, we learn that Isaac Merritt Singer was producing a range of highly popular sewing machines. Singer's sales force travelled the length and breadth of the country selling these marvellous machines to families and businesses that, until this time, had been sewing by hand. Singer soon

became the victim of his own success, however, because while he was able to sell vast quantities of the new machines, bringing them back to the head office for service and repair was both costly and highly cumbersome; moreover, it was occupying too much of his representatives' time and consequently sales were starting to fall.

Singer devised a plan whereby he would develop a network of licensed engineers, who would carry stocks of the most common components and repair the machines locally. The engineers were all self-employed and were paid directly by the customer, but could legitimately call themselves 'official licensed repairers' of Singer's machines; the engineer would buy component stock from Singer and would also pay Singer a small percentage of the invoice price as a fee for being allowed to operate as an authorized repairer. This concept freed up the representatives' time to expand sales and gave their customers a local point of contact for a more efficiently handled repair or service.

Soon these repair engineers began selling replacement machines as the originally purchased machines wore out, and the concept of a true franchised dealer was born. These first franchisees held stocks of the latest Singer machines, which they would sell and repair locally, and they were expected to pay Singer a percentage of their sales turnover as a franchise fee. Consequently, the Singer Sewing Machine Company became the first business format franchisor. As Singer's business grew, it soon became apparent that the franchisees were making a solid living out of their relationship with the company, and Singer was inundated with applicants to become a licensed dealer. It became clear that some sort of selection process was required and the easiest one to implement was a financial entry barrier; if one could not afford to buy into the system, one could not join. Despite this payment being only a few dollars, it quickly sorted the genuine from the opportunistic applicants and allowed for a management structure with adequate training for the franchisee network to be funded independently of Singer's core profit margin. The business was so successful that others looked at the model as a method of expanding their own businesses.

CASE STUDY 1.1

McCormick Harvesting Machine Company – a pioneer franchisor

Cyrus Hall McCormick was an outstanding early American mechanic; he was a man of vision with a passion, and a genius at business development and marketing.

Even though McCormick manufactured reapers for sale as early as 1834, he did not sell any for the next six years, but was undaunted by



CASE STUDY 1.1 *continued*

this. Eventually, he sold two machines in 1840, seven in 1842, and fifty in 1844. The reaper was not suited to the hills of Virginia, where McCormick was based, and the conservative farmers were uncertain about buying expensive new machinery that needed to be repaired by a skilled mechanic.

When McCormick made a trip to America's Mid-West, however, things changed rapidly. He saw his opportunity in the endless and verdant prairies, with hundreds of miles of good rich soil with few trees and fewer rocks. When his fierce rival, Obed Hussey, moved east, Cyrus McCormick moved west and established himself in Chicago in 1847. At that time, Chicago was a small town of little more than 10,000 citizens, but McCormick built a factory there, and manufactured 500 machines in time for the harvest of 1848.

McCormick's skill in marketing resulted in him creating a complex business plan. He sold his machines at a fixed price, and if farmers could not afford the capital cost, they could pay by instalments, and he gave a guarantee of satisfaction.

Recognizing that his machines would be sold throughout the USA, McCormick quickly identified a major problem. His machines were used during the harvest period and if a farmer's machine needed spare parts from the Chicago factory, the crop would be ruined before they could be delivered and fitted. So McCormick set up a system of agencies which would sell his machines, give instruction to the buyers and supply spare parts. This was during the infancy of business format franchising, but it is clear that Cyrus McCormick's innovative approach to business helped to develop its current form.

This industrial revolution set up an arrangement whereby a business system would allow the latest technology to be distributed, sold and serviced over a vast physical area, without the costs of developing a fully owned and operated infrastructure. This system became known as 'business format franchising'.

The next big influence in the development of business format franchising arrived with the big soft-drinks manufacturers in the USA – Coca-Cola, 7-Up and Dr Pepper's Root Beer – when it was quickly discovered that shipping bottles of what was essentially carbonated sweet water around the continent was a phenomenally expensive operation. What was needed was a system whereby water, sugar and carbonation could be added at source to the vital ingredients of these popular drinks. The drinks companies started to produce syrups that could be added to locally sourced water and then carbonated at point of sale, giving rise to the famed American soda fountains. The proprietors of the soda fountains became fractional franchisees, paying a percentage of their soda sales to the drinks companies

who were supplying their base syrups. The concept of the fractional franchise arose because most soda fountains were in stores that sold other commodities – from hardware to ice-cream. The proprietors bought their syrups and equipment from the drinks companies and gave a percentage of their soda sales as a franchise fee.

Again, soda fountains became popular, and soon there were more applicants than there were 'territories' available, so the system of paying for a franchise was implemented, to include equipment, uniforms, training and a marketing package. Very soon, soda fountains moved into the mainstream and dedicated stores began to operate.

This was all around the time of the expansion of America's love of the motor-car, and with motor-cars came the need for petroleum spirit on which to run them. Owning vast numbers of petrol retailing outlets was prohibitively expensive, even for the wealthy American oil giants, so a system of franchised operators was introduced. A garage operator would buy the franchise for Standard Oil (Esso), or Texaco, or one of the other numerous oil producers, and the operators were supplied with petrol pumps in the oil company's livery, a sign to hang on their forecourt and other dedicated products from their chosen supplier. The franchising concept allowed for exceptional growth of outlets at minimal cost to the oil companies, and the race was on to get the widest coverage in the quickest time.

Similarly, as more and more cars appeared on American highways, so the need for competent local salesmen and repairers grew; after several motor manufacturers joined forces in 1910 under the banner of General Motors, so the concept of franchising extended to vehicle sales and repairs. Some say that General Motors emulated the Singer model of franchising; while others will suggest that they looked to Belgium and the rival business of Adam Opel (who, incidentally, came under the GM banner in 1929) for their inspiration. Opel, before manufacturing cars, had made sewing machines and it is said that Opel had adopted Singer's model and refined it for the European market; whichever story is true, General Motors set up hundreds of franchised automobile dealerships in a very short period of time and left the rest of the industry playing 'catch-up'.

The franchising model of business development proved so successful that it became the preferred method of retail expansion in America in the early part of the twentieth century; and despite wars, recessions and the mob, franchising flourished.

Following the success of the wartime cartoons featuring a muscular, spinach-eating sailor by the name of Popeye, and his friend, Wimpy, Joseph Lyons in England identified a strong American trademark and niche product and subsequently bought the non-US global rights to the Wimpy brand of hamburger restaurants, and with the rights to the brand brought the concept of business format franchising to mainstream fast

food in the UK. Growing the business through franchising was so successful that Lyons very quickly applied the model to his other business divisions, and the jingle of the Lyons Maid ice cream franchise was soon to be heard throughout the nation.

Many other businesses followed Lyons' franchising model and now the world has a vast number of franchised businesses, but success did not come without some problems. In the 1970s the commercial world was rocked by the shame of the pyramid selling scandal; unsuspecting 'pyramiders' were offered the opportunity of vast wealth merely by introducing friends to the pyramid. As the new pyramiders paid their entry fees to the person who introduced them, the fee was passed up the line, being diluted increasingly until the organizer of the pyramid scam received a vast quantity of small remunerations, making him or her exceedingly wealthy.

Like most scams, this had no real basis for success, but there were some slight similarities to business format franchising, and consequently the franchise industry was tainted by the scam. It was clear that there needed to be some control over the industry, and in many countries regulatory legislation was introduced. Following the British tradition of self-regulation, several franchisors joined forces to create the forerunner of the British Franchise Association, and in the USA a similar organization was formed, with global aspirations, under the banner of the International Franchise Association.

With the growth of the European Union, the BFA and other European national franchising bodies affiliated under the European Franchising Federation, each retaining its own identity but all subscribing to a European set of principles and a code of ethics that would create a level playing field for franchising throughout Europe.

Therefore, we can see that what started life as an efficient method of collecting taxes from the distant corners of empires has developed into a highly successful business expansion model and as business opportunities evolve, one can be sure that franchising will develop in more refined forms to meet the needs of commercial evolution.

Pyramid selling:
a practice adopted by some manufacturers of advertising for distributors, and selling them batches of goods. The first distributors then advertise for more distributors, who are sold subdivisions of the original batches at an increased price. This process continues until the final distributors are left with a stock that is unsaleable except at a loss.

INDEX

Notes: **bold** = extended discussion or term highlighted in text; f = figure.

- accountability **131**, 237
 accountancy 131, 169–70, 171, **184**
 ‘simplistic approach’ 185
 accountants 8, 159–60, 193, 218
 accounting and finance 61f, 61
 ‘ACCURATE’ mnemonic 226, 227f
 acquisition agreement **160–1**
 adaptability **69**
 adhocracy 147
 advertising 10, 62, 64, 113, 127, 169, 172,
 186, 224, 226
 for recruitment of individual franchisees
 89–90
 age **136**
 Age (Melbourne) **234–5**
 agents **22**, 23, 32
 Alberta 181
 ale houses 4–6
 Aliouche, H. 198f, 252
 ambiguity 97, 98, 101, 160
Animal Farm (Orwell, 1945) 74
 arbitration **174–6**
 assets, maintenance in good order
 213
 ‘attribution theory’ (psychology) 57
 Australia 114, 196, 197f, 249
 Australian Competition & Consumer
 Commission 20
 Austria 196, 200, 249
 availability **133**

 Bakshi, V. **202–3**
 bank managers **139–40**
 bankers 131, 152, 187
 banking 69, 121
 bankruptcy 126, 173

 banks 38, 47, 52, 116, 117–18, 128, 149,
 160, 185
 Bargain Booze 47
 bargaining power **77**
 Barroso, J.M. 107
 Belgium 9, 97, 196, 200, 249
 Bharat Petroleum Corporation Ltd (BPCL)
 203
 bicycles 232, 233
 Big Mac 41, 53, 75
 Big Mac Index 197, 197f
 Birmingham 106
 blame stage 56f, **57**
 boards of directors 102, 102f, 103, 115,
 216
 ‘directors’ xiii, 165
 bounty **24**
 brand awareness/recognition 36, 110
 brand development 59, 60f
 brand image 27, 107, 235
 brand name 98, 100–1, 178, 224
 brand offering 31–2
 brand ownership 13f, **13–14**
 brand reputation 85, 87, 101, 105, 166,
 168, 171, 172, 175, 177, 183, 184, 212
 brands 23, 36, 43, 47, 48, 49, 54, 60, 72,
 74, 86, 119, 119f, 121–2, 125, 137, 149,
 204, 233
 global 195
 Brazil 197f, 249
 brewing **4–6**
 Brighton 107
 Britain *see* United Kingdom
 British Franchise Association (BFA) 8, 10,
 14, 19, 27, 36, 223, 250
 BFA/NatWest surveys 36, 223, 224, 233

- broadband **227–9**
 BRW 227–8
 budgeting 202
 franchisor help to franchisees 185
 Burger King 47, 48
 business and communication services
 144
 business concepts (new) 31
 business format franchising 5f, **6–10**
 see also cross-border franchising
 Business Format Franchisors 36
 business management software 226
 business models **76**, 114, 117–18, 229
 business plans 53, 116–17, 182, 183,
 220
 incorporation of exit strategy **208–9**
 business relationship ('ongoing') **21**, 21f
 businesses
 failure rate 36
 trendy short-term 25
 business-to-business (B2B) 142, **147–8**,
 185
 buying a franchise 117, 123, 125,
 135–58

 Cadbury, G. 106
 Cadbury, R. 106
 Café au Lait **180–1**
 Canada 81, 104, **180–1**, 196, 197f
 Canadian Franchise Association (CFA)
 103, 181, 249
 Cape Town Fish Market (CTFM) Restaurant
 32–4
 capital 31, 44, 199, 209, 223
 car dealers 52
 carbon footprint 107, **232–3**, 234, 235
 Carbon Trust (UK) 231
 caretaker franchisee 173
 Cartridge World 107
caveat emptor 186
 central Europe 1
 CEOs 215, 220
 change **236**
 Chicago 106
 children/childcare 49, 112
 China 109, 197f, 204, 249

 Church, the 4
 cities 180
 clarity 56f, **58**, 59, **163**, 209
 Clark, C. 106
 Clark, J. 106
 closing the business (exit strategy) 211f,
 215–16
 'doomsday scenario' 215–16
 co-branding 200f, **204–5**
 Coca-Cola 8, 195
 codes of ethics **83–4**, 148, 181
 see also EFF code of ethics
 Coffee Republic 107
 Columbus, C. 1
 commercial colonialism 195
 commission 24, 126
 common law 89
 commonality **17**
 communication 44, 63f, **63–5**, 67, 68, 104,
 120, **144**, 190, **247**
 Community Trade Mark (CTM, EU) 123
 company expansion **199**, 200f
 'most expensive method' (overseas
 franchising) 199
 competition 35, 189, **190–3**, 196, 198f,
 215
 competitive advantage 192, 194, 222
 competitor inventory **191**
 complacency 214
 comprehensive training **21**, 21f
 confidentiality 87–8, 176
 conflict management **34–5**
 Connaught Plaza Restaurants Pvt Ltd
 202
 consultants 117, 122, 128, 193, 213, 215
 conflict of interest **115–16**
 see also franchise consultants
 contracts 17, 20, 22, 35, 72
 see also franchise agreements
 contractual agreement **21**, 21f
 control/s 41, 68
 'thorny problem' in franchising 31–2
 'control mechanisms' 124
 copyright 98
 Cornwall 153
 corporate culture **191**

- corporate social impact (CSI) 108
 'ripple' effect 108f
- corporate social responsibility (CSR)
105–9
 definition 105
 sustainable 106f
- corporate strategy 102, 102f
- cost-to-value equation 44
- country risk factors **198f**
- 'creative' businesses **24–5**
- credibility **152**, 158, 221
- credit facilities 186–7
- Cromwell, O. 4
- cross-border franchising **200–1**
see also ethical franchising
- Crowell, H.P. 106
- culture 196, 198f, 200, 236
- customer base 100, 105, 136, **212**
- customer databases 223, 225
- customer retention **133**
- customer satisfaction **114**
- customer service 114, 228, 229
- customers 73, 74
 stakeholder in franchise 59, 60f, 60
- customers' business **132**
- 'Dabbah Wallah', food-delivery Indian-style
26–8
- damages 165
- death 8, 77, 128, 218
- debt **51–2**, 73, 91, 177, 184
- decision-making 72, 227f
- delay (by franchisor) **95**
- Delligatti, J. 53
- Denmark 197f, 249
- dentistry 28, 29
- deposits **161**
- design and printing service **227–9**
- Detroit 66
- direct control model 200f, **200–1**
- disabilities 236
- disclosure **89–94**, **130–1**, 157, 181
see also openness
- discount operators 224
- discounting (by franchisor) **95**, 125–6
- discretionary spending 127, 195
- dispute resolution 88, 89, **104**, 160, 162,
173, **174–6**, **248**
- distribution/distributors **22**, 23
- diversity 236
- Domino's Pizza 47, 48, 111
- Dr Pepper's Root Beer 8
- Dréo, J. 106n
- dry-cleaning **234–5**
- due diligence **126–7**, 135, 158, 180
- Dunkin' Donuts 36
- duty of care 94
- duty of fair dealing **181**
- dynastic succession 211f, **213–15**
 key concerns **215**
 unravelling 218–19
see also family
- earnings **46f**, **104**
 'salaries and bonuses' 210
 'eco warriors' 230, 231
- economic crisis (global, 2007–) 27, 44,
 68–9, 73, 74, 107, 117, 126, **127**, 141,
 233, 237
- economic recessions 50
 threat to 'lifestyle' businesses 210
- economies of scale 28, 38, 99
- Economist, The* 197, 197f
- écu d'or 2
- Edinburgh 107
- educational attainment 79
- elation stage **55–6**, 56f
- electrical equipment 232
- electronic mail 223
- electronic point of sale (EPoS) 184,
 225–6
- emerging markets 196
- emotional turbulence **55–9**
- empire-building **195**
- employee relations **192**
- employees 118–19
 stakeholder in franchise 59, 60f
- employment contracts 121
- England 2, 3–4, 73
- enthusiasm **78**
- entrepreneurs **71–82**, 146, 218

- entrepreneurship 33–4, 35, 48, **77**, 234
- environmental responsibility **231–2**
- estate agents 22
- ethical franchising 8, 38, **83–109**, 125–6, 130, 224
- definition 83–4
 - seven rules **21–2**, 40
 - social responsibility **105–8**
 - see also* franchising
- Ethiopia 106
- ethnicity 236
- ‘eureka’ moment 58, 73
- Euro/Eurozone 2, 197f
- European Commission 107
- European Commission: Regulation (EU) 330/2010 167
- European Community 96
- European Currency Unit (ECU) 2
- European Franchise Federation (EFF, 1972–) 10, 14, 84, 238
- aims **238**
 - conditions for membership **238–9**
- European Franchise Federation: Code of Ethics (1972; updated subsequently) **238–42**
- definition of franchising **239–40**
 - franchise contracts **96–102**, **241–2**
 - guiding principles **84–9**, **240–1**
 - master-franchise system **242**
 - recruitment, advertising, disclosure **89–94**, **241**
 - selection of individual franchisees **94–6**, **241**
 - see also* IFA
- European Union 10, 96–7, 123
- competition laws **167–8**
- executive single operator franchise **143**
- exit strategies 135–6, **207–21**
- benefits **208**
 - closing the business 211f, **215–16**
 - dynastic succession 211f, **213–15**
 - forced 207–8
 - Papa Antonio’s story **216–20**
 - selling the business 211f, **212–13**
 - stock market flotation 211f, **220–1**
- exit strategy flow chart 211f
- expansion (too much) **126**
- experience 53, 57, 64, 115, 145–6, 148, 179, 196
- extranet sites 63
- Facebook 192
- factories 227–9
- fads/crazes **25–6**, 150
- fair trade 107
- fairness 53, **88–9**
- family 46f, 46, 48, 49, 73, 81
- see also* dynastic succession
- ‘family’ businesses 208
- ‘farm-to-fork’ philosophy 107, 108
- fast food 9–10, 18, 28, 73, 77, 101, 107, 122, 144, 149, 171, 192, **202–3**, 204, 236
- feasibility studies 115, 117, 123
- third-generation 115
- Federal Trade Commission: Franchise Rule (USA, 1979) 93
- fee structure 13f, **14**, 21f, **21–2**, 159, 171, 196
- feedback 77, 124, 229
- fees 3, 4, 7, 9, 10, 17, 19, 20, 23, 38, 40f, 41, 47–8, 73–4, 77, 87–8, 91–5, 98–100, 118, 125–6, 135, 149, 154–5, 161–2, 167–8, 175, **183–5**, 186, 205
- initial 183
 - see also* management fees
- fiduciary duty 176
- financial advisers 221
- financial blues stage 56f, 56
- financial entry barrier 7
- financial operating instructions 121
- financial statements 91
- Finland 97, 230, 249
- ‘first franchisee’ 119
- first-to-market 31
- flexibility 40f, **73**, 210
- ‘football ambassadors’ 106
- four cornerstones 12, 13f, **13–14**, 17, 20
- fractional franchise concept 9
- France 196, 249
- French franc 2
 - French Revolution 2

- 'franchise' 171
 etymology 1, 2
 'more of hire agreement than outright purchase' 161
 service-based 112
- franchise accounts 61f, 62
- franchise agreements/contracts xiii, 13f, 14, 15, 16, 34, 38, 40, 57, 67, 68, 74, 76–7, 84, 90, 96–102, 120, 123, 131, 159, 160–6, 207, 217, 241–2
- basis for renewal 99–100
- breaches 88, 89
- buy-outs 34–5
- dispute resolution 173, 174–6
- duration 99
- dynastic succession 211f, 213–15
- exclusivity element 165, 166
- financial matters 182–7
- forced termination 176–7
- franchisee's obligations 170f, 171–4
- franchisees (sale or transfer of franchised business) 100
- franchisor's obligations 168–70
- franchisor's pre-emption rights 100
- 'identical across the network' 164–5
- imbalanced nature 161–2, 162f, 187, 204, 237
- intellectual property rights 100–1, 122
- legal counsel review 104
- obligations of franchisor 98
- obligations of individual franchisees 98
- opening of new outlets 180–1
- parties 165
- post-contractual restrictions 175–6
- post-launch stage 165
- post-termination 178–9
- pre-launch stage 165–6
- protection of system 100–1
- provision for continuing advice 169
- purposes 162–3
- renewal clause 165, 167–8, 176, 209
- right of franchisors to adapt franchise system to changed methods 101
- 'right to sell' conditions 177
- rights granted to franchisor 98
- rights granted to individual franchisee 98
- termination 101–2, 176–8, 209, 216
- terms of payment by individual franchisees 99
- third parties 170, 173
- timespan 167–8
- variables 165
- 'what is not written' 160
- franchise brokers 157–8
- Franchise Business* 227–9
- franchise consultants 42, 68, 75, 96, 217–18, 219
see also franchise lawyers
- Franchise Council of Australia (FCA) 19–20, 84
- franchise development 138–41
 four stages 137f, 137
 growing a business 137f, 137
 managing a business 137f
 selecting a business 137f, 137
 starting a business 137f
- Franchise Development Manager 150
- Franchise Disclosure Document (FDD, USA) 93–4, 95, 130
- franchise lawyers 76, 91, 94, 96, 97, 123, 128, 181
see also law
- franchise relationship 50–70
 emotional turbulence 55–9
 good (three elements) 63f
 innovation 53–4
 negotiation 51–3
 secret of success 62–9
 stakeholders 59–62
- franchise system
 'must always be controlled by franchisor' 54
 'not going to adapt to franchisees' 140
 successful 247
 successful ('no short cut') 115
- franchised business: cultivation 96, 110–34
- post-launch 123–33
- pre-launch 114–23

- franchisee committee **63**, 102, 102f
- franchisee skills acronym **139f**
- franchisees 7–8, **13**, 16, **22**
- advantages of franchising **36–40**
 - becoming a customer (of the competition) **192**
 - business expansion **190–3**
 - checklist of tasks in quest to find right franchise **156–7**
 - developing the business **189–206**
 - disadvantages of franchising 40f, **40–3**
 - 'dishonest' 35
 - disillusionment 126, 127
 - dissatisfaction 177
 - 'disruptive' **34–5**
 - existing **153–4**
 - exit strategy flow chart 211f
 - financial matters **186–7**
 - first-refusal rights 180, 190
 - ideal type 72, **138–41**
 - investment-protection **180–1**
 - 'little scope for personalizing their own business' 174
 - local responsibilities 61f
 - obligations 170f, **171–4**
 - 'pass through several stages before they reach full potential' **55**
 - peaks and troughs 177
 - poacher-turned-gamekeeper 179
 - premises 169, **172**
 - 'really successful' 71–2
 - reasons for becoming business owners **209–10**
 - reasons for failure **50–1**
 - responsibilities 72–3
 - rights and obligations **98**
 - sale or transfer of franchised business **100**
 - selection **94–6**, **241**
 - stakeholder in the franchise 59, 60f, 60
 - terms of payment **99**
 - understanding of franchise **76**
 - verifiable operating data 87
 - see also* prospective franchisees
- franchises
- acquisition **7–8**, **135–58**, **243–4**
 - assignment or sub-assignment 173
 - boosting broadband (case study) **227–9**
 - conduct **244–5**
 - description **166–7**
 - phases 150, **151f**
 - resales 177–8
 - rights granted **166–7**
 - steps to buying **135–58**
 - termination **245**
 - types **141–4**
 - well-known (advantages and disadvantages) 47
- Franchises Act (Alberta) 181
- franchising **xiii–xiv**
- advantages for franchisee **36–40**, 40f
 - advantages for franchisor **30–4**, 40f
 - Australian definition ('somewhat superficial' **19–20**)
 - author's definition **20–4**
 - British definition ('falls short on crucial issues') **19**
 - core business functions 61f, **61–2**
 - definitions **12–29**, 43, **239–40**
 - developing the business **189–206**
 - disadvantages for franchisee 40f, **40–3**
 - disadvantages for franchisor **34–5**, 40f
 - disciplinary action 169
 - 'does not suit everybody' **138**
 - early years **2–4**
 - emotional wheel 56f
 - 'enigma' 71
 - entrepreneurs **71–82**
 - ethical management 102f; *see also* ethical franchising
 - European definition ('convoluted but accurate') **14–16**
 - financial matters **155**
 - foundations **246–7**
 - 'four cornerstones' 12, 13f, **13–14**, 17, 20
 - future **222–37**
 - guiding principles **84–9**, **240–1**

- legal and financial matters 149,
159–88
- ‘long-term commitment’ 145
- ‘low-cost option’ (inaccurate belief)
30–1, 35
- versus marriage 51, 54
- ‘marriage guidance’ **62–5**
- ‘nine Ps’ 131, **132f**, 133
- ‘not a quick fix’ 133
- origins and history **1–11**
- overseas **194–9**
- practicality **24–9**
- pros and cons **30–49**
- risk factors 150, **151f**
- ‘seven deadly sins’ **131–3**
- ‘seven pillars’ 12, 114
- ‘shotgun’ approach 112
- six segments **144–58**
- social responsibility **105–8**
- ‘strength’ 125
- timeline **5f**
- US definition (‘leaves much to be
desired’) **16–19**
- weakness 43
- winning together as team **247**
- women **78–81**
see also ‘green’ franchising
- Franchising Code of Conduct (Australia)
20
- franchising ‘goats’ 72
- Franchising World* 141
- franchisor cycle 111f
- franchisor risk factors,
international franchising 198f
- franchisor-dominant approaches 69
- franchisor–franchisee relationship
imbalanced **161–2**, 162f, 187, 204,
237
- ‘very root’ 175
- franchisor’s directory 121
- franchisors 7–8, **12–13**, 16
advantages of franchising **30–4**, 40f
background research by potential
franchisees **75**
- ‘bargains’ to attract potential
franchisees 186
- ‘clean break’ from existing franchisees
214
- conflict with franchisees **34–5**
- core responsibilities 226
- disadvantages of franchising **34–5**, 40f
- disclosure (to prospective franchisees)
89–94
- enlightened 58
- exit strategy 209, 211f
- financial matters **182–6**
- ‘good’ versus ‘excellent’ 190
- international expansion (manner)
199–205
- new 76
- obligations **168–70**
- ‘over-ambitious’ 125
- overseas expansion **194–9**
- potential lines of questioning by
prospective franchisees **151–6**
- pre-emption rights **100**
- priorities 72
- recruitment, advertising, disclosure
89–94, **241**
- recruitment of suitable franchisees
(expenditure) 93
- right to adapt franchise system to
changed methods **101**
- responsibilities 61f
- rights and obligations **98**
- selection of individual franchisees **94–6**
- sharp practice **95–6**
- stakeholder in franchise 59, 60f
- ‘three golden rules’ for keeping
franchisees happy **68–9**
- under-capitalization 75–6
- what is not said **153**
- frango* (Latin) 2
- Franks 2
- ‘frantapreneurs’ **72**, **73**, **74**, **75**, **78**
- free-market economies 237
- Friedman, M. 105
- Fry, J.S. 106
- Gates, W.H. 38
- GDP 196, 197
- General Motors 9

- Germany 4, 196, 200, 249
 glass-ceiling 79
 globalization 195, 205
 'good character' 91
 'good deal' 51
 'good neighbours' 196, 229
 goodwill 18, **21**, 21f, 171, 177, 178, 225
 governments **195**
 'Great Unknown' franchise opportunity 124
 greed 183
 green audits **231**
 green champions **231**
 'green' franchising 222, **229–35**
 financial payback 231
 matrix 231f
 'not just clean, but green' **234–5**
 see also home-based franchising
 greengrocery businesses 24, 25
 grocery franchises 225–6
 'guardians/custodians of network' 64, 84, 94, 97, 193
- Hard Castle Restaurant Pvt Ltd 202
 hardware 228, 229
 head offices 201, 205, 223, 225
 health and safety 61f, 62, 121
 heirs 211f, **213–15**
 hobbies **146–7**
 Holme, R. 105, 254
 home-based franchising
 advantages and disadvantages **43–7**
 advice **45–7**
 key facts 45, 46f
 see also management franchises
 homepreneurs **43**, 44
 distractions **45**, 46f
 hotels 143, **144**
 human nature 72
 human resources 61f, 62
 Hungary 217, 249
- Illinois 104
 incentive **24**
 independence principle 15, 17, 20, **21**, 21f, 31, 32, 40–1, 57, 71, 73
 independent valuation (franchise resale) 178
 India **202–3**, 204, 249
 Indo-Asian News Service (IANS) **202–3**
 Indonesia 197f
 inflation 183, 198f
 information technology 61f, 62, 121, **222–5**, 226, 229, 237
 obsolescence 223
 innovation **53–4**, 69
 inquisitiveness **76**
 insolvency 208
 intellectual property 8, 54, 97, 100–1, **121–2**, 163, 166
 interdependence 58–9
 interest charges 52, 73
 International Franchise Association (IFA) 8, 10, 16, 68, 84, 103, 250
 Code of Ethics **246–8**
 see also *Trade Practices 1998* (Australia)
 international trade mark 123
 internet 75, 147, 222, 224, 228, 229
 online sales 224
 intranet 64, 224, 225
 intrapreneurs **71**, **72**, 73–4, 77
 investment 18, 20, 44, **46f**, 47, 75–6, 95, **99**, 128, 154, 182, 186–7, 201–2, 223, 235
 investment franchise 43, **143–4**
 investment-protection **180–1**
 investors 24, 208–9, 219, 220–1, 236
 IPO 211f
 Ireland 196
 Irish Sea 201
 Italy 216, 217, 249
- Japan 197f, 249
 job franchise **142–3**
 job satisfaction **145**, 147
 joint venture agreements
 'more evenly balanced' than franchise agreements 204
 joint ventures 200f, **204**
 versus 'master franchising' 204
 Joshi, H. 27

- Judaism 172
 'just-in-time' stock control 226
- KFC 106
 know-how 16, 17, **18**, 54, 87, 88, 93
 know-how agreements 22, 23
 Kolkata 203
 Kroc, R. 113
 Krugmann, D. **32–4**
 Kumar, S. **26–8**
 Kwalikleen **65–8**, 70
- language **97**
 Latin 2
 law xiii, 2, 8, 12, 14, 17, 19, 20, 28, 96,
 101, 104, 130, 191, 196, 198f, 230,
248
 rented property (UK) 146
 statute law versus common law **122–3**
 lawyers 8, 42, 68, 159–60, **163–4**, 168,
 174, 193, 218
 'legal counsel' 104
 non-specialist **164**
 specialist 217
 see also specialist professional advice
 leadership 34, 74
 Leeds 27
 legal documents **103–4**
 legal questions 224
 Leicester: De Montfort University xiii
 licensing 13f, **14**
 licensing agreements 22–3
 licensing laws 192
 lifestyle 8, **112**, 136, 156, 220, 235
 lifestyle businesses 80, **210[–]212**
 light bulbs 230, 232
 limited liability companies 165, 173, 210,
 212
 limited liability partnership 165
 litigation 92, 115, 174, **175**, 221
 local knowledge 31, 40f
 location **141–2**
 logos **100**, 178
 London 4, 33, 107, 216, 217
 London School of Economics 36
 loneliness **46f**
- longevity **77–8**
 Louis IX, King St 2
Louis d'or 2
 low-margin businesses 24, **25**
 loyalty cards 226
 Lyons, J. 5f, **9–10**, 236
- Madrid System (trade marks) 123
Making Good Sense (World Business
 Council for Sustainable Development,
 2000) 105, 254
 Malaysia 197f, 249
 management buy-out (MBO) 213, 219–20
 management fees 35, 127, 173
 see also fees
 management franchises **112–13**, **142**
 see also manual single operator
 franchise
 managing director (MD) 115–16, 233
 Manchester 26, 27, 48
 Manderson, M. 229
 manual single operator franchise **142–3**
 see also master franchising
 manufacturing 145
 market changes 60–1
 market mix 131
 market niches 77
 identification 27
 market research 124, **192**, 201
 market saturation 194
 market share 31, 32, 189, **193**, 194, 196
 market testing 119
 see also pilot operations
 marketing 15, 46–7, 61f, 62, 72, 119, 148,
 169, 190–1, 226
 'four Ps' 131
 markets 236
 pre-existing 72
 'markets with a conscience' (Barroso)
 107
 master franchising 24, 101–2, 135–6,
 200f, **201–2**, **242**
 versus joint ventures 204
 see also office-based franchises
 McAloo Tikki Burger 203
 McCormick, C.H. 6

- McCormick Harvesting Machine Company
5f, 223
- McDonald, D. 113
- McDonald, L.J. **103–5**
- McDonald, M. 113
- McDonald's 47, 48, 53, 75, 105, 111, 114,
195, 230, 236
 growing (catering to Indian tastes)
 202–3
- megalomania 194
- mergers (as exit strategy) 212
- Mexico 197f, 249
- Michigan 48, 65, 68
- middle class 197
- Middle East 203
- Middlesex 166–7
- military personnel **140–1**
- mindset 118
- ministers 230
- minorities 236
- 'misleading' statements 89, **90**
- Mission Statement 120
- mobile outlets **73–4**
- mompreneurs 105
- Monga, S.S. 203
- Morinelli, A. **216–20**
- Moscow 48, 195
- motivation 166, 231f
- motor cars 5f, 9, 65, 73
- multi-unit operators **128–9**
- Murphy's Law 202
- Mutz Nutz Mobile Pet Grooming
(advertising and promotion, 2008–)
126–7
- Naples 216
- National Franchise Mediation Program
(NFMP, USA) **248**
- national franchising associations
249–50
 see also trade associations
- national sales campaigns **127**
- negotiation **51–3**, 76, 77, 128
- 'negotiation respite' gambit 52–3
- Netherlands 196, 200, 250
- network marketing 24
- networking 46, 66
- networks 50, 58, 61, 63–4, 69, 82, 84,
87–8, 95, 97–8, 122, 124–5, 127, 131,
163, 169, 171, 173, 183, 186, 193,
201–2, 205, 209, 212, 215–16, 224–5,
233
 profitability time-lag 182
- New Delhi 203
- new product development 31
- New Zealand 196, 250
- nine Ps (of franchising) 131, **132f**
- 'no advantage' businesses 29
- non-disclosure guideline 87–8
- Northumberland 167
- Norway 197f
- Nottingham 27
- Nottingham Goose Fair 3
- Obama, B. 141
- objectivity 73, **115**
- office-based franchises 18
 see also overseas franchises
- Ontario 181
- Opel, A. 9
- openness/transparency **68–9**, 87, 89,
102, 104, 128, 186, 193, 228, 244,
247
 see also disclosure
- operational matters **155**
- operations manual 98, **120–2**, 162, 169,
175
 'fundamental creed of franchise' 120
- operations 61f, 62
- opportunism 7, 95
- Orwell, G. 74
- outsourcing 147
- overseas expansion models **199–205**
 case study **202–3**
 co-branding 200f, **204–5**
 company expansion **199**, 200f
 direct control 200f, **200–1**
 joint ventures 200f, **204**
 master franchising 200f, **201–2**
- overseas franchises **194–9**
 'not an inexpensive option' 194, 204
 risk assessment model **198f**

- target market **196–7**, 198f
see also business format franchising
- ownership **34–5**, 71
- partnerships **16**, 165, 195, 218–19
see also sole traders
- people **132f**
- perchloroethylene (Perc) **234–5**
- perseverance **132f**
- personal services **144**
- personality 41, 57
- 'personalizations' 54
- philanthropy **106**
- physical barriers 200–1
- physical evidence **132f**
- pilot operations 36, **37**, 75, 85, 86, 91,
114–15, **117–20**, 123, 125, 130, 152,
 164, 182, 184, 199, 218
 identification of 'critical success factors'
 119f
 operations manual 120
- Pittsburgh 53
- pizzerias 217
- place **132f**
- Poland 197f
- political stability 195
- post-launch phase (franchised business)
123–33
- 'pre-contracts' **92–3**
- pre-launch phase **114–23**
- premium pricing 37
- pre-prospective franchisee 140–1
- price **132f**
 'not be-all and end-all' 192
- price, product, promotion, place ('four Ps'
 of marketing) 131
- price wars
 'only way to go is down' 224
- price watching **192**
- pride **132f**
- principals and agents 22
- prisoner stage 56f, **57**, 59
- processes **132f**
- product consistency 38
- product quality 59, 60f, 87
- products 72, 119, **132f**, **133**
- products and services 69, 150, 236
- profit-sharing agreements 180
- profit and loss (P&L) statements 185
- profit margins 25–6, 32, 35, 53, 127, 171
- profit motive 56, 83, 85, 105
- profitability 37, 64, 92, 110, 120, 155, 182,
212, 220–1, 230, 234
- profits 38, 40f, 41, 48–9, 51, 57, 59, 183,
 201
 green franchising 233
- project plan 116–17
- promotion (of franchise) 61f, 62
- promotional mix **132f**
- property services **144**
- 'prospective franchisees' **138–41**
 contacting existing franchisees **8**,
104
 questions to ask of target franchisors
151–6
see also franchisees
- 'prospects' 50
- psychology 55, 57
- public relations 232
- public transport 233
- publicity (adverse) 175
- 'purchasing' a franchise ('slightly
 inaccurate' concept) 161
- purchasing power 197
- pyramid selling 5f, **10**, **23–4**, 192
- Quaker Oats Company 106
- quality 31, 175
 products and services **213**
- quality control 202, **232**
- quality of service 59, 60f
- questionnaires 138
- recruitment 48, 50, 125, 152
 recruitment of individual franchisees
89–94
- recycling 107, 233
- references **152**
- Regional Development 201
- registered trademark . **122–3**
- 'relevant information' 90–1
- religion 4, **172**

- rental income 169
 rental property market 146
 repair engineers 7
 replicable business model **21**, 21f
 'representative' offices 205
 reputation 18, 97, 105, **191–2**, 195, 229
 restrictive reference lists (supplied by franchisor) **95–6**
 retail franchises 18, 49, 116, **141–2**, 164, 165, 178, 204, 237
 retailing **73–4**, **144**, 228, 229
 retirement 218, 219, 220
 return on investment 77, 85, 118, 125, 144–5, 149, 167–8, 177, 183, 215, 221
 'Reynolds, David and June' 65
 right to ply a trade **178–9**
 Rio Tinto 105
 risk 36, 38, 40f, 62, 74, 75, 77, 79, 81, 105, 119, 125, 164, 187, 193
 country risk factors **198f**
 political 197
 Robin Hood 3
 Roman Empire 1, **2–3**, 5f
 Roman Senate 2–3
 Ronald McDonald House charity 105
 Rosenberg, W. 36
 Rowntree, J. 106
 Royal Dutch/Shell Group 105
 royalty payments 56, 125, 183, 209
 'rule of silence' 52
 Russian Federation 114, 195, 197f, 204, 250
- S&P500 Index 36, 37f
 sale 'but a gift until paid for' **185**
 sales brochures 192
 sales intelligence [information] 225
 sales representatives 127
 salespeople **126–7**
 Schlenrich, U. 198f, 252
 Scotland 153
 self-discipline **46f**
 self-employment xiii, 7, **32**, 71, 118, 187
 self-objectivity **138–41**
 sell-by and use-by dates 225
 selling the business 211f, **212–13**
- service marks **100**
 service quality 87
 service sector 18, 72, 113, 114, 122, **144**, 145, 148
 seven deadly sins (of franchising) **131–3**
 Seven-Up 8
 sewing machines 6–7, 9
 Shared Earth 107
 shareholders 105, 173, 220
 shareholdings 221
 sharp practice 156
 Sheffield 27
 sheriffs 3–4, 5f
 shouting **113**
 Singer, I.M. **6–7**
 Singer Sewing Machine Company 5f, **6–7**, 9, 223
 single-unit operations 129
 skills **142–3**, 144–5, 158, 218, 236
 B2B franchising **148**
 small business sector 44
 social media **192–3**
 social responsibility 83–4
 soda fountains 8–9
 solar power 230, 232, 233
 sole traders 165, 210
 see also partnerships
 solutions **133**
 solvency **152**
 Somerset 106
 South Africa **32–4**, 197f, 250
 South Korea 197f
 Spanish Inquisition 76
 Späten (German brewer) 4, 5f
 'special' deals 125
 specialist franchises 178, 179
 specialist professional advice **159–60**, 163
 see also consultants
 speeding up process (by franchisor) **95**
 sports cars 146–7
 staffing 121, 142, 171, 173, 192, 201, 202, **212–13**
 overseas expansion 194–5
 'personnel management' 113
 stakeholders **59–62**, 69

- Standard Oil (Esso) 9
- stock control 121, 184, 186, **225–7**
 ‘ACCURATE’ mnemonic 226, 227f
- stock market flotation 211f, 219, **220–1**
- store signs/business signs **100**, 178
- strategic business unit (SBU) 199
- strawberries **225–6**
- strictness **46f**
- sub-franchisees 215
- sub-franchisor 101–2
- subsidiary companies 199
- Subway 47, 48
- Sunray, A. 106n
- ‘super-franchises’ 201–2
- suppliers 37–8, 91, 171
 stakeholder in the franchise 59, 60f, 60
- supply and demand 178
- support **69**
- Sweden 197f, 250
- Switzerland 197f, 250
- Tanzania 33
- target market 113
- targeted marketing 226
- tax collection 3–4, 5f, 6, 10, 11
- taxation 4, 8, 73, 121, 184, 215, 232, **247**
- teamwork 55, 56f, **58–9**, 69
- technical assistance 85, 86
- technical businesses 28
- telephone 223, 226, 228
- territorial rights 15, 17, 42, 77, 94, 100, 127, 128, 129, 166, 179, 180, 182, 183, 216
- Texaco 9
- ‘them-and-us’ culture 64
- ‘thinking outside the box’ 53–4
- third-party pilot franchisee 164
- tied houses 6
- Tim Horton’s 107
- time 49, 85, 90, **99**, 125, 128, **133**, **167–8**, 170–1, 174–6, 179, 182, 186, 218
 nineteenth century 4, 106
 twentieth century 9, 78–9
 post-war era (1945–) 79
 1970s 10
- twenty-first century 5f, 69, 105, 147, 237
- future **46f**, **222–37**
- tithes 3–4
- trade associations 5f, **103**, 148, 152–3, 193
 ‘professional associations’ 160
see also national franchising associations
- trade mark 18, 19, 20, 85, 86, **100**, 121, 168
- trade mark law **122–3**
- trade name 16, 18, 19, 20, 85, 86, 98, **100–1**, 121, **122**, 123
- Trade Practices (Industry Codes-Franchising) Regulations of 1998* (Australia) 20, 84
see also World Franchise Council’s Principles of Ethics
- training 16, 17–18, 19, 23, 28, 35, 38, 42, 48, 66, 85, 86, 100, 121, 128, 139, 149, 152, **153–4**, 155, 158, 168, 171, 189, 190
- training manuals 154
- ‘transferable skills’ **146**
- transport and vehicle services **144**
- trends **192**
- trust 64, 107, 116, 175–7, **181**, 205, 221
- Turkey 197f, 250
- turnover 42, 49, 73, 87, 118, 127, 185, 193, 203, 230
 ‘guarantee’ schemes 92
- Twitter 192
- uncertainty
 acceptance **75**
 minimization **75–6**
- ‘understand what is being said’ principle **76**
- Uniform Franchise Offering Circular (UFOC, USA) 8, 104
- United Kingdom 4, 5f, 7, 9–10, 15, 47, 65–8, 107, 122, 130, 146, 160, 196, 197f, 223, 231, 233, 236
 financial crisis (current) 27, 44
see also British Franchise Association

- United States 1, 5f, **7–8**, 9, 10, 44, 65–8, 79–81, 93–5, 103–4, 107, 114, 127, 130, 141, 155, 196, **246–8**
 top fifty public franchises 36, 37f
see also International Franchise Association
- University of New Hampshire: Rosenberg International Center of Franchising 36, 37f, 198f
 Franchise 50 Index 36, 37f
 unregistered trademark **122–3**
 us and them scenario **132–3**
- value-added 192, 224
 value-added tax (VAT) 11, 121, 184–5
 value-maximization 207, 208, 209
 van-based franchises 18
 Vancouver 180
 vehicles 9, 52, 121, 186, 232, 233
 Versace, G. 25
 ‘vertical agreements’ (EU) **167–8**
 video conferencing **232–3**
 Vision Statement 120
- wait and review period **8, 104**
 waste 229, 230, 233
 websites **129–30**, 192, 223, **257**
 Weihs, J. 228
- Wheldon, J. **7–8**
 white-collar job franchise **143**
 William the Conqueror 3, 5f
 wills and testaments 136
 ‘estate’ (*post-mortem*) 173
 Wimpy chain 5f, 9–10, 236
 wind turbines 233
 women **78–81**, 236
 success factors **80–1**
 Women’s Franchise Committee (USA) 81
 Women’s Franchise Network (Canada) 81
 work–life balance 80
 working capital 48, 157, 186
 World Business Council for Sustainable Development 105
 World Franchise Council (WFC) 84, 148, 152, 156
 World Franchise Council’s Principles of Ethics **243–5**
 acquisition of franchise **243–4**
 conduct of franchise **244–5**
 termination of franchise **245**
see also code of ethics
- Yellow Pages 113
 York 106
 YouTube 192