FRANCHISING AS AN ALTERNATIVE WAY OF CREATION AND FINANCIAL DEVELOPMENT OF SMES

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The article defines the main features of enterprise creation through application of such method as franchising. The subject of research is mainly focused on SMEs and start-ups which face a lot of obstacles at the stage of creation as a lack of funding and experience in the majority of cases. The main idea or the article is to analyze the peculiarities of the initiation and operation of small and medium business structures by the means of franchising. Franchising was identified as an appropriate way for company creation in order to eliminate risk of business failure and loss of invested capital. The authors considered the stages for start-up implementation and analyzed the main obstacles to SMEs development in Ukraine. The main principles of how to apply franchising into business activity were examined in the research. The analysis was related to the dynamics of franchising market development in Ukraine, as the result of which the main characteristics were underlined. The elements of analysis could be exemplified as number of franchisors in Ukraine, number of own and franchising entities of franchising companies, franchising entities in the context of industry branches, comparative characteristics by industry indicators and the origin of franchising brands. The franchising market in Ukraine was also analyzed by such criteria as amount of required investment. The selection was made by types of investment. As the result of the mentioned selection such franchises, presented on Ukrainian market, as RockFellow, VillaTerra, Fornetti were analyzed. The advantages and disadvantages of each franchise were determined.
INTRODUCTION

Small and medium-sized enterprises should become drivers of economic growth of the country. However, their creation is quite risky for business owners. Major entrepreneurs might not manage to start their own businesses, and that part of people who dare to do that has a large possibility to fail because of lack of funds, experience, or irrelevant idea.

The main obstacle to the opening of their own businesses is often the lack of start-up capital. The vast majority of businesses in Ukraine chose the initial path of funding at the expense of their own savings, because this option is the most conservative and safe. But some entrepreneurs are beginning to seek alternative sources of funds.

There are various options to raise funds. The most widespread — obtaining bank loans. However, in Ukraine, the majority of entrepreneurs are skeptical of this alternative, because bank loans that currently available in the market is a loan, that has an interest rate which does not allow to further develop its business: no funds for reinvestment are left, all received proceeds are sent to repay loans. This creates a situation where the cause of insolvency of newly established enterprises become bank loans.

Nowadays more and more popular becomes an attracting a new funds via crowdfunding. This method has a problem of raising funds for common and ordinary small and medium business (further SME). Under the word “ordinary” understands a business, which has no revolutionary technologies, a grand idea that solves the painful problem of modernity, humanity, or something else that it would be interesting for a significant number of people to invest in the project even small amounts of money.

In these adverse realities of business creation, an alternative that could solve the problems of business startups is absolutely necessary. The alternative has to be less risky and costly, than other methods, and to provide an opportunity and preconditions for quick payback and development of SMEs.

AN OVERVIEW OF THE LATEST SOURCES OF RESEARCH AND PUBLICATIONS

Researchers managing the issues of franchising development as the way for raising enterprise success are engaged in such scientists as: Chandra Mishra (2017), Barbara Beshel (2001), Richard Boll (2016), Esther Calderón-Monge, Ivan Pastor-Sanz and Pilar Huerta-Zavala (2017) and others.
The purpose of the article is to analyze the peculiarities of the initiation and operation of small and medium business structures by the means of franchising.

In accordance with the stated goal, the following tasks were identified:
- define the main obstacles for SMEs development in Ukraine;
- analyze the dynamics of franchising market in Ukraine;
- select types of franchise according to criterion of required investment sum;
- make comparative analysis of main advantages and disadvantages for franchisor and franchisee.

### Table 1. Stages for businessman-beginner

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<tr>
<td>Before starting a specific action, a novice businessman should carefully consider his business idea. To do this, you need to analyze the market, which is planned to work. Currently, there is a wide range of tools for exploring a particular niche. The main question that faces an entrepreneur whether there will be a demand for proposed business ideas. If so, who will be the consumer, how much money will be in demand, whether the business will be useful for a society and what problems it will solve.</td>
<td>After defining a business idea, an analysis of the market participants, will take place. At this step the study of competitors, their advantages and disadvantages, the best strategy for attracting customers are exist. It is much more difficult for beginners to pay attention to themselves, therefore, in the presence of free funds, it makes sense to attract experts for analysis. In order to save money, you can do research on their own. However, you need to understand what factors can affect the choice of the consumer it prefer you, rather than your competitors. The most common metodu evaluation of promising projects are SWOT-analysis that future entrepreneur can use independently.</td>
<td>The elaborated and substantiated business idea must be presented in the form of a business plan. It is advisable to find out the purchase prices of goods and equipment, the cost of logistics and office leasing, the level of salaries in the sector, the terms of cooperation with sellers, to predict financial flows and timing. The result of creating a business plan is a 50% of successful project. With a detailed and effective business plan, you can start to a business partner or investor.</td>
<td>An own business usually begins with the registration of an individual entrepreneur. As a result of growth of turnover and requirements from clients, the company often re-registers itself to a limited liability company.</td>
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### Table 2. Obstacles to the development of SMEs in Ukraine in 2017

<table>
<thead>
<tr>
<th>Obstacles</th>
<th>Small enterprises</th>
<th>Medium enterprises</th>
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<tbody>
<tr>
<td></td>
<td>I quarter 2017</td>
<td>II quarter 2017</td>
</tr>
<tr>
<td>Not enough orders / low demand for products</td>
<td>73.9</td>
<td>70.5</td>
</tr>
<tr>
<td>Problem of liquidity / shortage of working capital</td>
<td>36.0</td>
<td>37.3</td>
</tr>
<tr>
<td>High level of competition</td>
<td>36.0</td>
<td>38.4</td>
</tr>
<tr>
<td>High tax load (tax rates and administration)</td>
<td>35.1</td>
<td>40.0</td>
</tr>
<tr>
<td>Unfavorable political situation</td>
<td>26.1</td>
<td>29.5</td>
</tr>
<tr>
<td>High regulatory pressure (unclear legislation, inspections, bureaucracy)</td>
<td>24.3</td>
<td>23.6</td>
</tr>
<tr>
<td>High rate of loans</td>
<td>23.4</td>
<td>15.2</td>
</tr>
<tr>
<td>Lack of raw materials</td>
<td>19.8</td>
<td>17</td>
</tr>
<tr>
<td>Frequent changes of economic legislation</td>
<td>17.1</td>
<td>11.6</td>
</tr>
<tr>
<td>Oxidation technology</td>
<td>12.6</td>
<td>12.7</td>
</tr>
<tr>
<td>Problems with power supply</td>
<td>8.1</td>
<td>6.4</td>
</tr>
<tr>
<td>Lack of production capacity</td>
<td>5.4</td>
<td>6.3</td>
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the search for qualified staff and administration, business development and design selection in accordance with franchise terms.

Franchising is a good option not only from the side of the franchisee, but also from the side of the franchisor, because any firm at the development stage faces the problem of slowing down the development of its network. In this case, franchising is an effective way to quickly create a network of facilities under the brand of the future franchisor.

The dynamics of the franchising market in Ukraine is depicted in fig 1—4 [Source 12]. Nowadays the franchising market is experiencing a qualitative growth in system franchises. In 2017 there was a decline due to the exit of "fake" franchises from the market. 2-international franchises are planned to have been released to Ukraine by the end of 2018.

The trend of development and launch of franchising in chains has not changed for the last 3 years. On average, companies that sell franchises have 25% of their own facilities, all the other facilities are developed at the expense of a franchise. Over the past year, many more franchise companies

Table 3. The main principles of franchising cooperation

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<tr>
<th>Principles for franchisor</th>
<th>Principles for franchisee</th>
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<tr>
<td>• owns a trademark, know-how, commercial experience, business reputation, other intangible assets.</td>
<td>• manages a business under the franchisor’s name as an independent entrepreneur; the franchisee can be both a legal entity and an individual entrepreneur; his earnings are profit from activities;</td>
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<tr>
<td>• has a proven and successful business idea.</td>
<td>• owns the property located at the point of sale of goods and services;</td>
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<tr>
<td>• passes knowledge to franchisee about how to operate their own need (know-how).</td>
<td>• pays the franchise value (one time), as well as periodic deductions for the use of the franchise (directly in the form of payments, or indirectly in surcharges for goods purchased from the franchisor);</td>
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<tr>
<td>• aims at the easy and successful development of the franchise network and its brand.</td>
<td>• often has no opportunity to independently determine prices for goods or services at the point of sale of goods and services sold for a franchise;</td>
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<tr>
<td>• seeks to receive a stable income for franchises, by obtaining a fee (royalty) from a franchisee.</td>
<td>• has the ability to form independently assortment of goods and services within the limits defined by the franchisor</td>
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<tr>
<td>• interested in a synergistic effect</td>
<td></td>
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Fig. 1. Trend data of the number of franchisors in Ukraine, 2001—2018

Fig. 2. Number of own and franchising entities of franchising companies, 2015—2017
have been formalizing their sales by means of franchise agreements.

It’s been three years since services started heading the list from the point of view of quantity. Nowadays more services are being created and developing in the logistic, childcare and beauty areas. Retailing still does not feel very active due to a large investment. Catering is steadily developing in the leading areas.

There are still many open opportunities and areas in the Ukrainian market. Today, a significant share of the...
market in the number of franchising facilities is occupied by international companies accessing cheap resources. Ukrainian companies each year take 7% of their share due to pricing and low-cost labor. Consider the well-known franchises that are presented on the Ukrainian market.

The selection criterion specifies the amount of investment required to create a franchise business:
- the largest amount of investment;
- average investment amount;
- the smallest amount of investments.

These three categories correspond to the following franchises, respectively:
- RockFellow;
- VillaTerra;
- Fornetti.

Each franchise has its own peculiarities. Let’s start with the RockFellow franchise.

Features of the franchise. RockFellow offers to become the owners of a unique entertainment center that has no analogues in Ukraine. Having become a partner of RockFellow, the franchisee becomes the owner of a restaurant, a bar and a unique antikinoteatra.

To buy a franchise you need to make a lump sum of $50,000, investment in the business is $516,000. In this case, royalty — 5% of turnover, and advertising deductions — 1%. The average return on business is two and a half years. The profitability of a business ranges from 25 to 29% [9].

RockFellow offers its franchisee:
- the right to use the trademark and know-how;
- marketing and financial plan;
- project and design of all premises;
- technical project;
- support at all stages of business development;
- an effective CRM system;
- curriculum;
- Instructions and manuals for working with clients.

There are certain restrictions on the location of RockFellow institutions — they should be located in cities of regional significance.

Every franchisee has an individual manager. RockFellow also has a single Call Center, where franchisee can ask any questions about business organization.

Managers of RockFellow help the franchisee prepare a franchise point before opening. In addition, the franchisor helps partners in promoting social networks and gives recommendations on how to build effective communication with clients.

As we see, this franchise requires significant cash contributions. But on the Ukrainian market, there are other franchises with much lower prices. For an example, take Villa Terra.

VILLA terra — a modern building base, where you can buy everything you need to build your own home from the foundation to the roof. We have developed our own effective business strategy that takes into account all the wishes and requirements of our clients and allows us to choose the most effective solution for the client, as well as successfully execute orders for building materials for a full cycle of construction works.

So VILLA terra is a harmonious combination of three elements:
- Professional showroom, where you can get acquainted with the characteristics and make sure that you buy quality materials;
- A large building base from which you can immediately pick up a product;
- A small retail store where you can "complete" small consumables.

Franchise VILLA terra is a ready-made business model of construction business with:
- minimal risks;
- stable high income;
- customized and well-worked business processes;
- A network of leading Ukrainian and European suppliers that provide favorable conditions for cooperation;
- the best brands in the optimal range;
- minimum seasonal fluctuations due to the fact that the range of goods and services is shaped in such a way that provides customer needs throughout the year;
- effective management and promotion technologies.

Basic franchise terms:
- Total investment: $ 280,000;
- Lump sum contribution (Kyiv, Kharkiv, Dnipro, Lviv): $ 30,000;
- Lump sum contribution (other cities): $ 20,000;
- Royalties: 1.5% of revenue per month;
- Advertising deductions: 0.5% of revenue per month;
- Geography of development: cities-millionaires and regional centers [10].

One of the least sought after investments in the Ukrainian market is a franchise "TM FORNETTI". TM FORNETTI is known in more than 26 countries of the world. In Ukraine, the franchising network is represented by 550 bakeries of different formats, with the help of which more than 500,000 kg of baking is sold monthly. Updated author’s design, a wide range of pastry buns, sandwiches, desserts, a unique coffee blend, author’s teas, refreshing drinks, the atmosphere of a new European format of Fornetti bakery-cafes [11].

Features of the franchise.
- Brand book;
- Design project;
- Repair on a turn-key basis;
- Software;
- Standards for the operation of the bakery FORNETTI (Visualization standard, Standard technology, Standard of service, Standard of work with an additional assortment, Standard of work in the accounting system F24);
- System training and certification of personnel;
- Support and support of the franchisee throughout the period of cooperation;
- Assessment and approval of the location;
- Incomplete financial model;
- Special prices of suppliers;
- Marketing support;
- Run command;
- Festive opening of the bakery.
Investments range from $5,700, incl. Lump-sum contribution of $1,000. There are no royalties or deductions for franchise. Payback period — 6 months.

Based on the results of the theoretical research and the study of domestic experience of using franchising, we will define its advantages and disadvantages.

On the franchising market in Ukraine a considerable amount of franchises is presented. Franchises are divided into business, also conditionally — for cheaper and more expensive. Each franchise has its payback period, which is usually transparently counted in the business plan provided by the franchisor. Consequently, the entrepreneur can choose a franchise, not only comfortable for his sphere of activity, but also that which will correspond to his financial capabilities.

In the case of a standard business start-up procedure, it is difficult to take into account all the costs and expenses that an entrepreneur may incur, as new ideas are not yet presented on the market (there are no analogs). Franchising allows you to work with a well-known product and a popular brand, which already have a well-known consumer demand and is able to correctly calculate possible revenues, and, therefore, the risk of bankruptcy of the franchisee is quite small.

The interest in business success is on both sides, so the franchisor provides training for managers and staff of the franchisee both to the start of business and in the process of its activities.

The experience of other franchisees is systematized and generalized by the franchisor and used in the development of new projects. Consequently, the franchisee takes a minimum of complex — both financial decisions, and about the company’s activities. All franchisee’s discussion questions can be asked by the franchisor — this assistance is usually prescribed in the contract.

The financial advantage is that there is a practice of preferential lending between a franchisee and a franchisor. Lending can be carried out both in direct form (loans, participation in capital), and (more often) — in the indirect form (leasing, deferment of payment, payment by installments).

Franchising brings advantages associated with the high purchasing power of the franchisor. Since the franchisor has a developed franchising network, he can make wholesale purchases of all the franchisee’s activities necessary for him, and, consequently, has the ability to strive for strict compliance with the quality and discounts from suppliers.

It should be noted that besides the advantages, franchising is also characterized by certain disadvantages.

From the side of the franchisor the main disadvantage are the failures of the franchisees, which extend to the entire network. Insurance against failures is based solely on predicting possible risks before signing an agreement. In case of serious violations, the franchisor is obliged to terminate the contract or not to renew it for a new term. Thus, the franchisor depends on the willingness and ability of the franchisee to strictly observe the terms of the agreement.

Another disadvantage for us is the contradiction in the franchisee’s position in the franchising system.
Franchising contributes to the development of competition, creates new jobs, which positively affects the socio-economic development of the country as a whole.

The franchisee is interested in developing franchise points, therefore, it provides non-advisory, marketing and educational support.

Suckling franchisors help partners not only in business organization, but also support the franchisee in further actions. This avoids a number of mistakes that small and medium businesses can face with.

Today, franchising is the most effective way of expanding business. That is why successful brands choose this way of business development.

Any form of business organization has both advantages and a number of disadvantages. The main defects of franchising for the franchisee are:

— restriction of freedom of action in contrast to traditional entrepreneurship;
— the impossibility of a quick withdrawal from the franchise network, since the commercial concession agreement is concluded for 3 — 5 years.

Instead, franchising allows an entrepreneur to get a business that is already in demand among consumers. Consequently, the franchisee does not need to spend time and considerable resources on advertising and other methods of stimulating sales. A representative of small or medium-sized businesses becomes the owner of a reliable enterprise, which promotes the development of high-quality and profitable projects.

The franchisor is interested in having his partners open business at the earliest possible time. Therefore, it provides a list of reliable and financially vendors, or independently delivers the necessary products, raw materials and equipment. The franchisee also provides franchisee with clear instructions for action, promptly solving current problems.

Thus, franchising undoubtedly contributes to the development of small and medium-sized businesses, and also positively affects the whole economy of the country.

References: