9

Manufacturing franchising for managing the extended enterprise

A. S. Carrie, L E Hayfron and I. Dean
Department of Design, Manufacture and Engineering Management
University of Strathclyde
75 Montrose Street, Glasgow, G1 1XJ, Scotland, UK
Telephone +44 (0)141 548 2894
Fax +44 (0)141 552 0557
a.s.carrie@strath.ac.uk

Abstract

This paper presents the underlying concepts and aims of a new research project funded by UK's Engineering and Physical Sciences Research Council (EPSRC) into manufacturing franchising, and the preparatory work that has already been done.

Keywords

Franchising, Agile manufacture, Extended enterprise

1 INTRODUCTION

Franchising (Mendelsohn, 1992; Sherman, 1991; Shook and Shook, 1993) has been widely used in service industries but very little in manufacturing. In fact, Mendelsohn has identified four types of franchising, namely franchising between:

Retailer and retailers
Wholesaler and retailers
Manufacturer and retailers
Manufacturer and wholesalers

Organizing the Extended Enterprise P. Schönsleben, & A. Büchel (Eds.)

This paper describes some preliminary work (Chall, 1996; Dean 1995, 1996; Dean and Carrie 1996a, 1996b) and a research project based on the premise that a fifth type of franchising is highly appropriate in today's global manufacturing, namely franchising between:

Manufacturer and manufacturers.

With increasing globalisation of industry, manufacturers need to be agile in meeting customer requirements in diverse markets around the world. Franchising is a means by which manufacturers can establish facilities in new markets with a minimum of delay and capital.

2 FRANCHISING COMPARED WITH OTHER TYPES OF EXPANSION

A number of options are available for a manufacturer who wishes to establish small focused factories around the world close to their markets. The manufacturer can go it alone establishing new branches or collaborate with other manufacturing companies by licensing, franchising, establishing joint ventures or purchasing one of these manufacturing companies turning it into a wholly owned subsidiary. Dean (1995) has given a comparison of these approaches in relation to such characteristics as source of the business blueprint; initiation and training; support; policing and control; and fees and royalties.

New Branch

To establish the new branch the manufacturer must supply the business blueprint, initiation, training, and support. It has full control over the operation as it owns the branch, having made a considerable capital investment, and receives all the profits (or suffers losses) but receives no initial fee and royalties.

Wholly Owned Subsidiary

A manufacturer can acquire a manufacturing company already serving the market it wishes to enter. This acquisition becomes a wholly owned subsidiary. A blueprint, initiation, training, and support need not be supplied as the wholly owned subsidiary already has these in place. The new owner can police and control its new acquisition retaining all the profits.

Joint Venture

The manufacturer could form a joint venture with a suitable partner. Both partners, who are equal in the joint venture, supply the business blueprint, initiation, training, and support. Both can police and control the joint venture with both receiving a share of the profits.

Licensing or franchising

The manufacturer may realise that its production process contributes to its competitive advantage. Other manufacturing companies may be willing to pay for the use of this production process. Therefore, such a manufacturer might prefer to license or franchise this production process to other manufacturing companies. This brings in revenues whilst the license and franchise agreements limit who has access to the production technologies. There is a distinct difference between franchising and the typical licensing arrangement, as discussed below.

Licensing

The production process, along with associated trademarks and patents, could be supplied by licensing. The manufacturer would be the licensor and those who purchase the license would be licensees. However, the licensor does not supply a complete business blueprint. The licensee has to develop the use of the licensed technologies. Nor does the licensor provide support systems, initiation and training. The licensor doesn't have the right to police and control the licensee unless explicitly stated in the license agreement which also states the method of payment an initial fee *or* royalties.

Franchising

The production process can also be supplied by franchising it to other manufacturing companies. The manufacturer becomes a franchisor not only providing the production process but also supplying support services such as accountancy, human resource management, research and development from its home plant to those purchasing the franchise - the franchisees. The franchisee purchases a blueprint of the production process, receives initiation into the franchise network and training on how to use the production process and support from the franchisor. The franchisor receives an initial fee *and* royalties for this with the right to police and control franchisees. The fundamental difference between franchising and licensing is that with franchising, in addition to providing the right to use his process or product designs, the franchisor will provide support services, such as corporate marketing, and will also control the franchisee more directly. If manufacturing companies in other markets purchase the franchise then a franchise network will be formed. As a result the manufacturer has a network of new branches around the world with considerable power over them without the complete costs of establishing new plants.

Therefore, franchising offers distinct advantages if circumstances are appropriate. It provides a means of business expansion that enables rapid implementation with minimum capital investment and provides a prompt positive cash flow.

3 MANUFACTURING FRANCHISING DEFINED

Various features of franchising are implied in the above discussion. In the literature definitions of franchising vary from a few words in length to a full page of text. We have examined these and complied the following definition:
Manufacturing Franchising is the granting of a license by one party (the franchisor) to another (the franchisee) which entitles the latter to customize, manufacture, market, distribute and/or support goods and/or services, whereby the franchisor agrees to provide central commercial and technical support, and imposes the obligation to conduct a business in accordance with the Franchisor's concept for the term of a written franchise agreement.
Further main characteristics include the following:

- the franchisee uses the Franchisor's trade name, and/or mark and/or service mark, know-how, business and technical methods, procedural system, and other industrial and/or intellectual property rights.
- the franchisor provides training for the franchisee and his/her staff.
- the franchisee makes an up-front and periodic management services fees payment to the franchisor.
- the agreement is for a specific period only, which can be renewed.
- the business relationship is between legally and financially separate independent undertakings and is not a transaction between a holding company and its subsidiary (as defined in section 736 of the Companies Act 1985) or between subsidiaries of the same holding company or between an individual and a company controlled by that individual.

A franchised operation will appear indistinguishable to the customer from one another in terms of outlook and methods of operation (including customer service). Therefore the company's processes, both physical and managerial, must have the capability of being reproduced in a different market and operated by trained personnel other than those of the franchisor.

4 FRANCHISING AS A STRATEGY FOR AGILE MANUFACTURE

There is now a vast literature on the way industry is changing in response to competitive pressures, with terms such as Fractal factories, Virtual organisations, Extended enterprises and others entering the manufacturing management vocabulary. These pressures are forcing industry towards greater agility, mass customisation and virtual products. Under these new competitive pressures it will be increasingly unrealistic for a manufacturer who wishes to operate globally to ship products to diverse markets around the world from a single home base. Dean and Carrie, 1996b, gave a discussion of some of the factors affecting the search for agility, and how these related to franchising.

Dean (1995) noted that many of the tactics which industry is adopting to achieve agility also enable franchising. He identified nine core generic enablers:

Virtual Products
Customers increasingly want products made to their specification (Davidow and Malone, 1992; Goldman, et. al., 1995). Different customers will have different requirements. The design that satisfied one customer will need to be adapted for another. In franchising this could be implemented by permitting a franchisee to adapt designs for local markets.

Empowered Workforce
Empowerment means that staff must be trusted to take decisions. Franchisees will need to be empowered to adapt the production process to produce the product to meet customer's specifications.

Learning Organisation
The concept of the learning organisation is very relevant to franchising (Neergaard, 1994). The franchised factory must be a learning organisation so that it has staff skilled enough to make the adaptations and to share these adaptations amongst others in the franchise network to save their re-invention.

Business Process Re-engineering
The production process must be in a form that is capable of being franchised with support systems specific to the production process disentangled from the rest of the organisation. Probably few manufacturing organisations are sufficiently well defined and documented to facilitate duplication elsewhere. Business process re-engineering can be used to achieve this, remove unnecessary bureaucracy and help the franchised factory to adopt new technologies.

Flexible Manufacturing
Flexible manufacturing technologies, such as work cells, are needed. The production process has to be flexible so that it can be adapted to meet the customer's specifications.

Information Technology
Information technology has had an immense impact on manufacture. In franchising IT can allow immediate and effective communication between the franchisor and franchisees and allow the necessary information about customers and their demands to be managed.

Recognition of Paradoxes
Manufacturing businesses involve paradoxes that must be managed (Felstead, 1993; Miller and Stroh, 1994). Franchising, perhaps more than other kinds of business

organisation involves managing paradoxes, since it requires balancing the levels of centralisation, co-operation, ownership and revenues.

Federal Structure
A federal structure is needed to help the franchisor and franchisees manage these paradoxes and helps to produce the necessary levels of functional excellence and productivity to maintain market responsiveness.

Quality Function Deployment
The franchised factory will be customer focused and use appropriate tools, such as QFD, to maintain quality, whilst documenting adaptations allowing everyone in the franchise network to gain access to new designs.

The use of these enablers makes the resulting franchised factories sustainable. Any manufacturer considering taking up a manufacturer to manufacturer franchise will have to ensure that these enablers are included in the franchise package.

5 TYPES OF FRANCHISING - INWARD AND OUTWARD FRANCHISING – AND THE MOTIVATION OF FRANCHISOR AND FRANCHISEE

It is envisaged that franchising may be of interest in two directions of investment, namely inward and outward.

The UK has attracted the largest share of inward investment into Europe from overseas. Inward franchising is where an economic development organisation within a country might encourage overseas companies to set up franchise operations within its territory. It is frequently stated (albeit anecdotally) that inward investor OEM companies, especially those from Japan, have difficulty in finding local suppliers capable of achieving the required quality levels. A local company could set up a franchised operation for a Japanese supplier to the OEM. Due to the greater control that a franchisor has over its franchisee than a company has over a subcontractor, greater control over supply and quality levels may be achieved.

Outward franchising is where a company sets up franchise operations in overseas markets. It is a means of enabling companies to expand with a minimum of delay and capital outlay. This is particularly important for small companies wishing to operate on a world markets. Most of the discussion that follows relates to outward franchising.

In fact, these two types simply reflect the different viewpoints of the potential franchisor and potential franchisee. The desire of the franchisor to be able to respond quickly to market changes, and the financial rewards that come with this competitive advantage, can be the driving force behind manufacturing franchising. The franchisor is also motivated by the need to get closer to the market and customers' needs. This is facilitated by obtaining a good insight into the market from the knowledge of the prospective franchisees. The franchisor will also be able to enter marginal, non-prime markets with relatively little capital investment and operating costs. The franchisor can rely on highly motivated management team (the franchisees) which is working for itself rather than for salaries.

The motivation behind becoming a franchisee is to achieve successful long term self-employment and trade under an established name as well as making a profit.

6 AIM AND OBJECTIVES OF THE RESEARCH PROJECT

The overall aim of the research project is to assess and demonstrate the contribution franchising can make to manufacturing competitiveness and to business expansion as a form of extended enterprise. Supporting objectives include:

- To establish the types of company (parameters include size, product mix, sales volumes, product life cycles, etc.) for which franchising may yield business advantage.
- To assess the value of inward franchising as a means of building up the local UK supply base to foreign-owned OEMs.
- To assess and demonstrate the value of outward franchising, working with collaborating companies.
- To establish the most effective means of defining procedures and transferring this knowledge to franchisees and the role of IT in this.
- To assess the commercial and technical risks in franchising.

There are several collaborators on the project, including industrial companies, public bodies concerned with industrial development and commercial and consulting companies active in the franchising field. One of the collaborators provides drilling tubes to the oil companies. As part of its service it offers clients a complete tubular management service under which it will refurbish or replace and store tubes and supply them to drilling rigs. The oil business is global in nature and there are many new business opportunities for a company willing to operate on a global scale. The company is interested in using franchising as a means of entering these emerging overseas markets (such as Baku and Vietnam) as quickly and with as low a capital cost as possible while being able to guarantee API (American Petroleum Institute) standards of quality from the start. Another collaborator has several manufacturing operations in Europe and further afield. Several of these have been acquired as a result of take-over. The management systems that have proved successful at the main plant have to be replicated at the subsidiary operations. The company believes that franchising may provide a way of standardising the performance of these subsidiaries. The company is also interested in franchising as a means of entering alliances in new markets.

7 STEPS IN A FRANCHISING PROJECT

Guidance to potential franchisors on how to go about franchising will be a useful output of the project. A provisional project plan (developed from that given by Dean, 1995) for implementing franchising involves several steps:

Establish that the manufacturer has a distinct exploitable business opportunity

There must be a market for the products made by the production process that competitors are not currently satisfying. The production process must be an innovative concept with the firm holding trademarks and patents. Once franchised the production process must make enough revenue for both the franchisor and franchisee.

Assess the feasibility of using franchising

There are various aspects to this issue. If the benefits such as faster market penetration, better use of resources or harnessing a well motivated staff are desired, and if several of the enablers are already in place, then franchising is likely to be feasible. While a variety of businesses can be franchised, Duckett (1998) identified five essential features if a franchise is to be a success. These are:

- Image: The manufacturer must have a known brand name or reputation which potential customers recognise.
- Easy duplication: It must be possible to replicate the operation.
- Proven format: Potential franchisees must be able to see that the business works.
- Profitable: The business must make sufficient profit to satisfy both franchisees and franchisor.
- Franchising culture: The franchisor and franchisees must recognise each other's motivation and establish good communications and relationships.

Develop the business concept

Before procedures are transferred to franchisees, they should be re-engineered for maximum effectiveness, and if possible defined in such a way that they may be transferred in digestible packages. The concept must be presented in such a manner to attract franchisees. It is also essential that the concept is developed with the minimum of the franchisor's resources.

Establish a pilot operation

The pilot operation proves that the franchise works. It identifies problem areas that need to be resolved and the necessary training that staff of the franchisor and franchisee will need. The adapted production process and re-engineered support systems and operations manual can be tested in the pilot operation to see that they work. Investment in IT will be necessary.

Develop the franchise package
The package will involve methods of marketing, the likely turnover of the franchise, the setting of management fees, training and support requirements.

Develop the operations manual
The operations manual specifies how the production process works. Most firms already have this in embryonic form. The quality manuals needed for most quality standards such as ISO9000 can act as a basis for the operations manual. Details on how to use the support systems that the franchisor will supply will need to be written into the operations manual by the franchisor. The operations manual will be used in training franchisees and for their future reference and will be better developed if the franchisor has undertaken a pilot operation. The operations manual must have copyright protection and will be the principal reference authority.

Market the franchise and recruit franchisees
A franchise prospectus and the franchise agreement need to be drawn up and distributed to prospective franchisees. The pilot operation can be demonstrated to prospective franchisees. Care must be taken when selecting franchisees. The franchisee must have the necessary skills. A profile of the ideal franchisee should be developed to confirm that the prospective franchisee has the necessary skills. The franchisee must also have the capital to invest in the venture.

Train the franchisee's personnel
Training will be designed so that the company's processes, both physical and managerial, can be operated by franchisee's personnel. Training requirements will be best identified after review of the pilot operation.

Review the franchise operation
The franchisor must be able to review the success of the franchise. This requires that adequate performance measures must be in place. Manuals and methodology may have to be modified as a result of a review.

8 FRANCHISE OPERATIONS MANUAL

The Franchise Operations Manual is a crucial document since it specifies the procedures which franchisees must follow, and some of the legal arrangements between the parties. Although there is a substantial literature on franchising within the service sector, companies tend to treat their manuals as strictly confidential. However, analysis of some manuals, together with interviews with prominent practitioners in the industry has enabled contents of the operating manual to be developed. There will normally be three parts of a manual, dealing with initial set-up, operations management and training respectively. The main contents will be:

- SET-UP
  - Introduction, including mission statement (values and vision), purpose of the manual, history of the franchise, brand quality statement, confidentiality, statement of obligation, health and safety regulation and procedures, quality assurance policy, factory fittings
  - Business Plan
  - Production and Process Information: Factory design and layout, IT system specifications, Approved suppliers and equipment
  - Property (selection, insurance and security)
  - Performance standards and methods of assessment
- OPERATIONS
  - Franchise Network Support: investment and financial issues (evaluation), manufacturing operations, sourcing and logistics, crisis/contingency management, franchise support contact list, financial control
  - Marketing: brand communication, local marketing strategy and plan, promotions
  - Customer Service: franchise philosophy and standards, cultural issues, customer communication, handling of complaints
  - Administration: trade diary, commercial information, control and update of documents, IT systems, record of amendments
- TRAINING
  - job objectives and tasks
  - organisational charts
  - staff selection and recruitment
  - attaining franchise standards
  - brand training
  - management induction training
  - staff induction training
  - staff development training

9 TRANSFERING SERVICE INDUSTRY EXPERIENCE TO MANUFACTURING FRANCHISING

Part of the project is examining experience of franchising in service industry. It aims to assess the extent to which this experience will apply directly in manufacturing franchising, or whether it will need to be adapted in view of the different characteristics of manufacturing. Among the factors being considered are:

- Franchising Feasibility
- Franchisor and Franchisee Motivation
- Brand Name and Intellectual Property Rights
- Ownership of Premises and/or Equipment
- Risk Management

- Quality Issues
- Control of Franchisee Operations
- Information Technology
- Communication
- Performance Measures

Space does not permit a full discussion of these factors here. However, one example can be used to illustrate the differences. In service industry, especially in retailing, the franchisor often owns the premises and/or the plant used as a protection against the franchisee defaulting on his part of the contract or trying to set up in opposition. If one of the aims of franchising in manufacturing is to expand with the minimum of capital investment this strategy would not be appropriate. Hayfron, et al., 1998 discuss these factors at some length.

10 CONCLUSIONS

Franchising provides a means by which companies can expand their operations into new markets without the costs, delays and risks which would be involved if it attempted to enter each market on its own. As such, it represents a possible approach to managing the extended enterprise. A research project examining the opportunities and methods of franchising is underway.

11 REFERENCES

Chall, J. (1996) *Survey of near franchised factories*, BEng dissertation, University of Strathclyde, Glasgow, Scotland.

Davidow W. H. and Malone M. S., (1992) *The Virtual Corporation*, New York, HarperBusiness.

Dean, I. (1995) *The Franchised Factory Feasibility Study*, Internal Report, Manufacturing Systems Research Group, University of Strathclyde, Glasgow, Scotland.

Dean, I. (1996) *The contents of the franchise operations manual*, Internal Report, Manufacturing Systems Research Group, University of Strathclyde, Glasgow, Scotland.

Dean, I. and Carrie, A. S. (1996a) Future Enterprise Types and Strategies for Agile Manufacture, in *Advances in Production Management Systems*, (eds. N. Okino, H. Tamura and S Fujii) Proceedings of APMS'96 Conference, Kyoto, Japan, November 1996, IFIP, pp299-304.

Dean, I. and Carrie, A. S. (1996b) The Franchised Factory - A new paradigm for manufacture, in *Manufacturing Strategy: Operations strategy in a global context*, (ed. C. Voss), Proceedings of 3rd EurOMA Conference, London Business School, 2-3 June 1996, pp159-164.

Duckett, B. (1998) Challenges of turning a business into a franchise, in *The Franchise World Directory*, 14th edition, pp47-50, Companion Publications.

Felstead, A. (1993) *The Corporate Paradox: Power and control in the business franchise*, Routledge.

Goldman, S. L., Nagel, R. N. and Preiss, K. (1995) *Agile Competitors and Virtual Organizations: Strategies for enriching the customer*, Van Nostrand Reinhold.

Hayfron, L.E., Carrie, A.S., Bititci, U.S. and Pandya, K.V., *Manufacturing franchising: transferring the service experience*, Institution of Electrical Engineers workshop on Responsiveness in Manufacturing, London 23 February, 1998.

Mendelsohn, M. (1992) *The Guide to Franchising*, Cassell.

Miller W. W. and Stroh P. (1994) Learning to Thrive on Paradox, *Training and Development*, 48, 9, pp28-39

Neergaard C. (1994) *Creating A Learning Organisation: A Comprehensive Framework*, Ph.D. Thesis, Denmark, University of Aalborg

Sherman, A. J. (1991) *Franchising and Licensing: Two ways to build your business*, AMACOM.

Shook, C. and Shook, R. L. (1993) *Franchising: The business strategy that changed the world*. Prentice-Hall.

Warnecke, H. J. (1993) *The Fractal Company*, Springer-Verlag.

12 BIOGRAPHY

Allan Carrie

Allan Carrie is the Hoover Professor of Advanced Manufacturing Technology and Head of the Department of Design, Manufacture and Engineering Management at the University of Strathclyde. He is a Chartered Engineer, Fellow of the IEE and of the RSA, a Senior Member of IEEE and a Member of IOM. He has industrial experience as an Industrial Engineer with Babcock and Wilcox in UK and with Northern Electric in Montreal, Canada. He is the author of a book on simulation of manufacturing systems and over 130 papers. He served as a member of the Panel on Manufacturing, Production and Business Processes of the UK Technology Foresight Programme between 1994 and 1997. His main research interests are in computer aided production management and management of technology.

Lee Hayfron

Lee Hayfon is Research Associate on the Manufacturing Franchising project. He has a MSc degree in Information Systems Management and experience in service industry.

Ian Dean

Ian Dean was a postgraduate student at the University of Strathclyde between 1994 and 1996.