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The risk of developing a Lebanese brand

Is developing franchises risk free for Lebanese brand owners?

Recent market trend have shown a rush towards franchising. While the Middle East market is still growing and savvy of new food and beverage concepts, the road to franchising successfully is heavily ambushed and booby trapped. Lebanese operators often rush into a franchise in reaction to the regional demand. While the opportunity is genuine, the risks of failing to deliver are very high, and the damages can be high for both the franchisor and the franchisee.

What does it take to create a franchise?

The operating manual is the corner stone of the franchising activity. Yet it takes more than a compilation of memos and some written procedures to create a franchise. Franchising is a business on its own, and it extends beyond the normal restaurant operation.

With interesting cash perspectives and return on investments, Lebanese entrepreneurs have identified the great potential of the franchising activity. Revenues from the franchising activities can be weighty : a basic entry fee of around US$100,000 and royalties ranging from 5% to 7% of the outlet turn over.

Considering the case study of a medium sized outlet with an annual turnover of US$750,000, franchising around five outlets of such category with royalties at 5%, the franchisor would collect US$37,500 per outlet totaling US$187,500 per annum. With operating costs running at 50%, the profit margin of such activity would be in the region of US$100,000 per year.

Know-how and support

A franchisee seeks to acquire the know-how and support in managing the outlet, including planning, internal control, business development and human resources management.
Prior to franchising it, however, the outlet must be a successfully managed one, giving the franchisor the role of coaching and directing the franchisee in order to achieve higher performance.

On entering a franchise, the operator expects to receive a manual on "how to" with recommendations and highlights on dangers and operation weaknesses. In addition, the outlet manager hopes to find solutions for the daily operation challenges such as production consistencies, personnel insurances, purchasing and other internal control procedures.

The product

At the heart of a successful operation is the balanced product. This sends us back to the core of the restaurant business. A food and beverage product has two components: the tangible and the intangible.

Understanding the product is the most difficult duty of the manager. A successful operation combines the right attributes and components of the products. A successful manager is the one who plays on the right features to meet and exceed customers expectations.

> **"At the heart of a successful operation is a balanced product"**

The network

Franchising also offers the operator the opportunity to capitalize on acquired knowhow by using a network of contractors, suppliers and other economic partners. For example, some franchisors restrict interior design artifacts to designated suppliers under his direct supervision. This proves a good means to control the integrity of the product. A strong network can help the operators achieve economies of scale and reduce operating risks. Large franchised groups such as Mc Donalds conduct a yearly franchisee convention where franchisees are encouraged to bound and exchange best practices.

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The brand

The franchise is first of all a brand. The brand is the ultimate expression of a franchise. A well managed and exposed brand increases the chances of success and desirability of a franchise. Brand recognition is also what attracts the customer.

> **"Human resources is among the toughest challenges"**

The challenge is to have a cross border recognized brand. For example, a leading brand on the chicken fast food in KSA is the Saudi brand Al Baik, which operates 35 units in the Jeddah region alone. While this brand is widely known on the Jeddah market and in the KSA, it has not yet been exported outside this market. Furthermore, brand integrity is regularly challenged and tested in new markets. Customers expectations differ and the product must adapt.

Positioning is a key issue in the development of a brand. Upon entering the Lebanese market, Mc Donalds was positioned higher than the international norm, however, as the product interated, we observed a shift of strategy and a drop in the average check.

What does it take to operate a franchise?

There is a difference between the franchisee and master franchisee/ franchisor requirements. While the master franchisor must have the structural and financial support to lead-on a regional development, the franchisee must have the know-how to operate an outlet. The master franchisee-franchisor is often led by real estate opportunities in the development of brands.

Significantly, franchisees in the region do not always correspond to the profile recognized internationally: an operator, with know-how in search of support and branding. More often than not, franchisees in the region are large groups that are seeking to operate a franchise as part of an investment diversification strategy.

This imposes both a threat and challenges for the developers of franchises. Such large ventures are faced with the structural issues of creating an operator.

Success

Creating a franchise is not simply signing a franchise agreement with a franchisor.

Difference of objectives between franchisor & franchisee

Objectives of the franchisor	Objectives of the franchisee
Maximize profit	Maximize profit
Protect intellectual property	Acquire business know-how
Protect the brand	Protect investment
Insure the conformity of the outlet	Insure recyclability of the outlet
Minimize cost of support	Maximize franchise fees
Maximize franchisor support	Minimize cost of franchise
Maximize brand coverage	Maximize own geographic coverage
Secure the franchising contract	Secure an exit clause

The franchisor and the franchisee have different points of view on their relation. Negotiating the contract in full awareness of the difference of agendas can help reduce risks in developing the franchise.

Case study of one outlet

Title	Description	Amount
Revenue	Mid sized outlet	US $750,000
Franchise fees	5%	US $37,500
Net revenue	Gross revenue franchise fees	US$712,500
Franchise cost incidence	Impact of cost of franchises on the general outlet cost structure	1.053
Initial food cost	% on total revenue	25%
Adjusted food cost	% on total revenue after deduction of franchise fees	26.32%

Franchising is a complex and exhaustive process through which both franchisers and franchisees are gauged and tested, prior to reaching an agreement.

Franchising requires preparation and dedication from both parties. Indeed, while the franchisor has to provide all the guidelines and support the franchisee has to carefully plan and study his operation. The co-optation process can be lengthy and difficult, and often takes several months before an agreement is reached.

In the recent developments on the Lebanese market, franchising an outlet has become a natural sequel to operating an outlet. Indeed, Lebanon is considered as a showcase, where operators display their know-how and concepts. While there is a lot of creativity in the concept, often the premeditated development strategy is lacking.

Human resources is among the toughest challenges. While the food and beverage industry may compete on low end job scale and remuneration, it quickly looses ground on more senior positions, as the remuneration does not follow. Perhaps the solution is to take the example of a restaurant chain, who instated a program to develop entrepreneurs/managers for their restaurant. Hence the goal for each employee is to own and operate their own franchised restaurant.

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