

Implementation of Franchising as a Business Model in Croatian Business Context

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Abstract

Franchising is a young sector in transition in Croatia. Consisting of retailing, distribution, and wholesaling operations, companies in Croatia are now becoming aware of the benefits and costs of franchising as an organizational method and are considering its adaptation to the Croatian context. Still, franchising is underdeveloped with only a handful of active firms, lack of regulatory structure, lack of support from institutions, disinterested banks and little experience in the marketplace. Our proposed paper will investigate one company evaluating franchising for expansion and discuss the dilemmas it will face. Our contribution will be in assessment of franchising model embeddedness with regard to macroeconomic conditions in Croatia.

Key words

Franchise development; business environment; transition economies

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1 Introduction

Scientific research in the field of franchising as a business model has been conducted for over 30 years, but it was just during the 1990s that the interest of researchers for this area became more intense. Franchising becomes an increasingly interesting business concept to scientists and researchers from different areas⁴ – to entrepreneurship experts – because franchising represents a driving force for starting a business venture; to marketing experts – because it represents one of the main distribution channels in new economies; to strategic management experts – because it represents an important organizational form; and to financial experts as well – because they are interested in capital investment structure in franchise businesses.

The increase in the scientific community interest for franchise business coincides with the increased intensity of franchise business model implementation over the last two decades, especially visible in the USA and Europe (Alon & McKee, 1999). An International Franchise Association (IFA) research from 2004 shows that 45% of retail business in USA is conducted via franchising with over 18 million people employed directly or indirectly in over 80 different industries (IFA, 2004). According to European Franchise Federation (EFF) data, there are over 5500 franchisors with over 266.000 franchise locations in Europe.

Although franchise as a business model undoubtedly shows an exceptional potential and the adaptability to different industries and business environments – even four decades after the first franchise appeared in Croatian business environment – it still hasn't been fully developed as a business model. This paper explores the current condition of franchising in Croatia together with its development potential and tries to identify the main obstacles to a broader implementation and acceptance of franchising as a desirable business model for entrepreneurs looking to start or grow their businesses. The empirical part of this paper used the experience of Lens Company Ltd. as a reference case, combined with the survey conducted among bankers, lawyers and consultants interested in franchising. A number of stakeholders will benefit from this investigation: managers, investors, service providers (financiers, advisors), entrepreneurs, policy makers, researchers.

⁴ Combs J.G.; Ketchen Jr, D.J.: „Why Do Firms Use Franchising as an Entrepreneurial Strategy? A Meta-Analysis“, *Journal of Management*, 29(3), 2003, p. 444.

2. Background

2.1 Defining the concept of franchising

Franchise represents a business relationship where "... one firm (the franchisor) sells the right to market goods or services under its brand name and using its business practices to a second firm (the franchisee).⁵" Curan and Stansworth provided a broader definition "...a business form essentially consisting of an organization (the franchisor) with market-tested business package centered on a product or service, entering into a continuing contractual relationship with franchisees, typically self-financed and independently owner-managed small firms, operating under the franchisor's trade name to produce and/or market goods or services according to a format specified by the franchisor⁶."

Kidwell et al.⁷ emphasize that franchise concept is one of the key strategies for growing your business worldwide, however the success of this strategy relies heavily on the relationship developed between the franchisor and the franchisee, i.e. on the franchisor's ability to prevent opportunistic behavior on franchisee's side (e.g. lowering production costs which results in negative effect on product/service quality and thus can result in losing the brand identity). Combs et al. present two main distinctive characteristics⁸ of franchise in comparison to other organizational forms (e.g. strategic mergers): franchise business models are most often developed in industries where services are an important component and there is a need to bring them closer to the end-user; the other distinctive characteristic is the fact that franchise agreements commonly determine a unique allocation of responsibilities, decision-making rights and profit-sharing models between a centralized principal (franchisor) and decentralized agents (franchisees).

The majority of scientific research on franchise is based on the agency theory and/or resource scarcity theory. Major assumptions and predictions of these theories can be seen summarized in the Table 1.

⁵ Combs J.G., Michael, S.C., Castrogiovanni, G.J.: „Franchising: A Review and Avenues to Greater Theoretical Diversity“, *Journal of Management*, 30(6), 2004, p. 907

⁶ Curan J., Stanworth J.: „Franchising in the modern economy/towards a theoretical understanding“, *International Small Business Journal*, 2(1), 1983, p.8.

⁷ Kidwell R.E., Nygaard A., Silkoset R.: „Antecedents and effects of free riding in the franchisor-franchisee relationship“, *Journal of Business Venturing*, 22, 2007, p.523

⁸ Combs J.G., Michael, S.C., Castrogiovanni, G.J.: „Franchising: A Review and Avenues to Greater Theoretical Diversity“, *Journal of Management*, 30(6), 2004, p. 908

Table 1: Major assumptions and predictions about franchising by resource scarcity and agency theories

	Major assumptions	Major predictions
Resource Scarcity Theory	<p>Large chains possess substantial scale advantages</p> <p>Firm ownership is more profitable than franchisee ownership</p> <p>Franchisee labor (i.e. managerial ability and local market knowledge) and capital is easier to obtain than alternatives</p>	<p>Small/young firms are more likely to grow through franchising</p> <p>Franchising is related to growth and survival, but not necessarily profitability</p> <p>Mature firms will grow through firm ownership and by repurchasing existing franchises</p>
Agency Theory	<p>Economic actors are rational and self-interested</p> <p>Economic actors have different goals but are otherwise homogeneous</p> <p>Franchising substitutes powerful ownership incentives for costly direct monitoring</p> <p>Employee-managers in company-owned outlets will shirk (vertical agency)</p> <p>Franchisees that do not depend on repeat business will free ride on the brand-building efforts of others (horizontal agency)</p>	<p>Firms will franchise those outlets that would be costly to monitor and where potential for free riding (horizontal agency) is low</p> <p>Franchise contracts will provide franchisees with a quasi-rent to keep them in the contract and optimally motivated</p> <p>Firms that franchise where it is most efficient to do so will have greater performance</p>

Source: Combs J.G., Michael, S.C., Castrogiovanni, G.J.: „Franchising: A Review and Avenues to Greater Theoretical Diversity“, Journal of Management, 30(6), 2004, p. 908

2.2. Advantages and disadvantages of franchising

Franchise agreement governs the business relationship between two parties – the franchisor and the franchisee. As it is the case with any business relationship, this

one also implies certain advantages for both parties, while each party agrees to a certain level of compromise when signing the agreement.

From a franchisor's viewpoint there are many advantages, i.e. arguments in favor of choosing franchising as a business expansion model: minimizing business risks, lower staffing needs, brand strengthening, increased competitiveness. Spasic⁹ outlines the following advantages of franchising from the franchisor's standpoint: rapid expansion, benefit of using local market expertise of the franchisee, better managerial skills combined with greater drive and motivation of the franchisee (when compared to an employed manager, e.g. an outlet manager); the biggest potential disadvantage is franchisee's infringement of agreement provisions dealing with quality standards. Parivodic¹⁰ identifies potential loss of control over the franchise network as one of the main disadvantages from a franchisor's viewpoint, with other authors listing several other disadvantages: lesser profit, potential conflicts with franchisees and the inability to influence franchisee's recruitment policy.

Franchisees, on the other hand, find starting their own business around a proven business idea and a well-known brand and trademark to be the major benefit from entering a franchisor's network. Other advantages include: training, economies of scale advantages, lesser possibility for errors in business process, product and quality standardization, access to franchisor's research programs knowledge base. Main disadvantages connected with franchise purchase are limited decision-making freedom, i.e. large amount of dependency on (sometimes) inflexible franchising system, agreement inequality of the parties and the obligation of paying all the financial obligations with no regard to the financial status of the franchisee.

However, despite all the potential disadvantages, franchising has become a broadly implemented business model with the main reason for creating this kind of business relationships being a healthy balance of mutual interests established between the franchisor and the franchisee where every franchisee's success contributes significantly to the development of the franchise network as a whole.

3. Environmental Analysis of Franchising in Croatia

3.1. Economic and Entrepreneurial Environment of Franchising

Franchising development possibilities in Croatia are directly influenced by the general state of Croatian economy. Economic indicators like GDP growth rate (as shown in the Table 2) and the unemployment rate (Table 3) over the last couple of years, together with the number of new companies established indicate a rather

⁹ Spasic I.: „Franchising business“, Institut za uporedno pravo, Beograd, 1996, p. 26

¹⁰ Parivodic, M.: „The International Franchising Law“, Službeni glasnik, Beograd, 2003 p. 54

slow rate of national economy recovery from the consequences of war, privatization processes and the economy transition processes.

Table 2: GDP per capita and growth rates for Croatia over the 2001-2006 period

	2001	2002	2003	2004	2005	2006
GDP per capita (EUR)	4997	5507	5905	6461	7038	7706
GDP year-on-year rate of growth	4,4	5,6	5,3	4,3	4,3	4,8

Source: Croatian National Bank (http://www.hnb.hr/statistika/ekonomski_indikatori.htm May 20, 2007)

Table 3: Unemployment rate in Croatia 2001-2006, by International Labor Organization, persons over 15 years of age

	2001	2002	2003	2004	2005	2006
Unemployment rate	15,8	14,8	14,3	13,8	12,7	11,2

Source: Croatian National Bank (http://www.hnb.hr/statistika/ekonomski_indikatori.htm May 20, 2007)

Key problems for Croatian economy development are¹¹:

1. unfinished transformation of the state into the service of its citizens and entrepreneurs (incomplete development of the “new role of the state”)
2. lack of an entrepreneurial climate
3. unfinished privatization and restructuring processes.

Low levels of entrepreneurial culture and climate combined with the prolonged privatization and restructuring processes, have slowed down investment processes by both domestic and foreign investors. Due to these prevailing economic conditions, foreign investors (potential franchisors included) still show a large level of cautiousness when considering business expansion to Croatia, and those who do decide to enter Croatian market have a hard time finding entrepreneurs interested in establishing business partnerships.

Although the figures for Croatia show the increase of entrepreneurial activity measured by TEA index year after year¹², Croatian entrepreneurship is

¹¹ „Strategic Development Framework 2006-2013“, Government of the Republic of Croatia – The Central Office for Development Strategy and Coordination of EU, Zagreb, 2006; p. 14

¹² Global Entrepreneurship Monitor (GEM) is a joint research project with 42 participating countries and the purpose of measuring entrepreneurial activity within participating countries, identifying factors of influence on entrepreneurial activity and drafting proposals for policy actions which can facilitate entrepreneurial activity level within a respective

characterized by larger number of entrepreneurs starting their businesses out of sheer necessity, (measured by TEA Necessity index) i.e. the need to solve their unemployment problems, in comparison to the number of entrepreneurs who are trying to seize a perceived market opportunity (measured by TEA Opportunity index). In 2005, Croatia was the only country within the GEM research project with TEA Necessity outnumbering the TEA Opportunity index. In 2006, however, Croatia managed to turn the numbers in favor of opportunity-seeking entrepreneurs, but still remains at the bottom of the 42 countries participating in this research project¹³. The "necessity entrepreneurs" embark on their business ventures with minimal investments and are unlikely to become potential franchisees that, as a rule of thumb, need to be able to invest larger initial capital in their business.

Table 4: TEA indexes for Croatia (2002-2006)

	2002	2003	2004	2005	2006
TEA	3,62	2,56	3,74	6,11	8,58
TEA Opportunity	2,18	1,74	2,04	2,92	4,41
TEA Necessity	0,85	0,59	1,57	3,09	3,81

Source: Singer et al.: „What makes Croatia an entrepreneurial country? Results of GEM Croatia research for 2006“, CEPOR – SME Policy Center, 2007, p.17

Table 5: Entrepreneurial Capacity of Croatian economy, 2006

		2006
Motivation index *	Croatia	1,16
	GEM countries average	6,06
Growing-up index **	Croatia	0,48
	GEM countries average	0,81

*ratio between TEA Opportunity and TEA Necessity

** ratio between "entrepreneurs" and "beginners and start-up entrepreneurs"

Source: Singer et al.: „What makes Croatia an entrepreneurial country? Results of GEM Croatia research for 2006“, CEPOR – SME Policy Center, 2007, p. 29

The other problem of Croatian entrepreneurship in the context of franchising development perspectives lies in the low rate of transition of start-up entrepreneurs to entrepreneurs active over 42 months, i.e. low "growing up" rate

country. Entrepreneurial activity is measured by TEA index which represents the percentage of start-up entrepreneurs in the total of adult population sample (age 18 to 64).

¹³ Singer et al.: „What makes Croatia an entrepreneurial country? - Results of GEM Croatia research for 2006“, CEPOR – SME Policy Center, 2007, p. 22

of business ventures and the low share of growing companies in the economic structure. Table 5 shows the ratio between TEA Necessity and TEA Opportunity indexes in 2006 and the "growing up" index which is even lower than the one measured in 2005 (0,48 for 2006, 0,60 for 2005). Businesses that successfully survive the transition phase and "grow up" can be observed as potential Croatian franchisors, and GEM research project indicates the insufficient pool of companies with the franchisor potential in Croatia.

Low potential of franchise systems development in Croatian companies is visible from information – both start-up entrepreneurs and their "grown-up" counterparts conduct their respective businesses in the environment of intense competition which implies the low innovativity levels of their products and services (Table 6).

Table 6: Expected competition intensity, 2006, percentage (How many entrepreneurs offer the same product?)

	2006
Start-up entrepreneurs	%
Many	53
A few	38
None	9
"Grown-up" entrepreneurs	%
Many	76
A few	23
None	1

Source: Singer et al.: „What makes Croatia an entrepreneurial country? Results of GEM Croatia research for 2006“, CEPOR – SME Policy Center, 2007, p. 33

According to the assessment of the public perception of corruption among public servants and politicians, conducted by Transparency International¹⁴ in 163 countries annually, Croatia ranks in 69th place. Croatian businessmen and analysts taking part in this assessment have given Croatia an overall grade of 3,4 (on a scale where 10 represents total lack of corruption and 0 represents a highly corrupt environment) which shows a high level of mistrust towards public institutions in Croatia. One of the key characteristics of franchising is a mutual trust relationship between the franchisors and the franchisee, because the franchisor enables the franchisee to use its brand name and business expertise. Low level of trust in Croatia does not represent a healthy basis for franchise partnership development.

¹⁴ „Global Corruption Report“, Transparency International, Cambridge University Press, 2007; p. 327

3.2. Legal Environment for Franchising in Croatia

Over the last couple of years Croatia has adopted numerous legal documents which enabled it the access WTO and CEFTA membership and laid the foundation for starting the negotiations for accession to the European Union. Nevertheless, there is currently no specific legal framework for franchising in Croatia.

The franchising agreement was first introduced to Croatian legal system by the Trade Act¹⁵. However, it is insufficiently regulated and is a result of business practice by which certain general provisions of the franchise agreement were established. Croatia is no exception in this matter; most legal systems in other countries don't have the franchise agreement legally regulated as well.

In accordance with the provisions of Article 21 of the Trade Act, it is defined what rights are provided to the franchisee by the Franchise Agreement, however, the Act doesn't clearly define the concept of franchise or the general provisions of the franchise agreement. A provision in the Article 21 of the Trade Act states that: "Franchise Agreement governs the business relationship where the franchisor – a specialized wholesale company and a company who developed a successful form of service business – provides the franchisee – a retail company or a service industry company, with the right to use the franchise with the purpose of selling certain types of products and/or services."¹⁶

Until October 1st 2003, in accordance to the provisions of the Competition Protection Act, Croatian legal system envisaged the obligation for every franchise agreement to be evaluated by Competition Protection Agency within thirty days upon the signing of the agreement. With the enforcement of the new Competition Protection Act, and in accordance to its provisions, the franchise "agreement" became a part of the agreements with certain limitations, however, they are not considered prohibited¹⁷. On the other hand, pursuant to Article 11 Section 4 of the Act, the Agency has the possibility to initiate an agreement evaluation procedure (this provision refers to franchising agreements as well) if the effects of the respective agreement (individual or cumulative) with other similar agreements in a relevant market don't fulfill the conditions for exclusion. These changes in the Competition Protection Act are the result of the screening process and the necessary adjustments of the Croatian legal system to the European Union legal system.

Since franchise business model takes advantage of all the economic functions of a trademark – guarantee, advertising, competitive and promotional, franchising is largely influenced by the provisions of the Trademark Act. The previous Trademark Act provided for the trademark assignment to be connected to the assignment of the technology which guarantees the same product and/or services

¹⁵ Trade Act, Official Gazette 49/03, www.nn.hr

¹⁶ Trade Act, Official Gazette 49/03, www.nn.hr

¹⁷ Competition Protection Act, Official Gazette 122/03, article 11, www.nn.hr, May 20, 2007

quality. The new Trademark Act (NN 173/03) no longer has this provision but a provision of the Article 699 of the Civil Obligations Act (NN 35/05) which ensures the quality of the products offered under the same trademark in licensing agreements can be applied. The trademark owner has a right to perform the necessary quality control actions to protect the quality standards of products and/or services sold under its trademark.

3.3. The Current State of Franchising in Croatia

3.3.1. Franchising Market in Croatia

Even though franchise business model is present in Croatia for over four decades, the real development of this business model still lies ahead. The first franchise came to Croatia in 1969 with Diners Club International. Franchise agreement enabled the franchisee based in Zagreb to operate in the whole former Yugoslavia and other Balkan countries. Croatian Diners Club franchisee was awarded twice by the franchisor for exceptional business results achieved in the Eastern European market¹⁸.

The first more significant discussions on the advantages and disadvantages of franchise business model came together with McDonald's which entered Croatian market in the early 1990s. McDonald's established a company McDonald's Hrvatska Ltd., signed business agreements with key suppliers – strategic partners in Croatia with some of them investing additionally in their production capacities to meet the needs and quality requirements of this multinational company. McDonald's expanded throughout Croatia by opening its own, "company" restaurants or by sub-franchising to other locations. McDonald's presentations in cities where the franchisor sought partners/franchisees generated great interest of potential franchisees with many questions referring to the nature of the franchise agreement offered by McDonald's, i.e. to the rights and obligations of both sides in a franchise relationship.

Couple of years after McDonald's, several other franchisors appeared on Croatian market with Hungarian bakery franchise Fornetti and an US restaurant franchise Subway standing out as the most recognizable ones.

According to the assessment of the Croatian Franchise Association¹⁹, there are currently around 120 franchises operating in Croatia (with 25 Croatian franchisors) (Table 7). The same source gives out the total of over 900 franchise locations with around 16000 employees. Franchising in Croatia encompasses 20

¹⁸ Viducic, Lj., Brcic, G. in Alon, I.; Welsh, D. (2001) „International Franchising in Emerging Markets: China, India and other Asian Countries“, CCH Inc., Chicago, p. 218

¹⁹ Round table „Franchising in Croatia“, adress given by Ms. Kuvec, Lj., president of Croatian Franchise Association, at EFF/IFA International Symposium, Brussels, October 24th-25th

different industries, and more than 20% of the total hospitality and trade industries are conducted by companies which use a franchise business model.

Table 7: Comparison of the number of franchises in Croatia and selected European countries

	Total number of franchises	Number of domestic franchisors
Croatia	125	Approx. 25-30
Czech Republic	90	Approx. 40
Slovenia	100	Approx. 40
Hungary	300	150
Poland	210	117

Source: EFF/IFA, International Symposium, Brussels, October 24th-25th

3.3.2. Institutional Support for Franchising in Croatia

Croatian Franchise Association was established in 2002 with main objectives to promote and advertise franchise licensing in Croatia, to group the franchisor companies comparing their feedback and to establish policies and standards for franchise licensing in Croatia.²⁰ Even though the mission and objectives of this Association are of great significance for franchisors in Croatia, especially taking into consideration low level of awareness on basic franchise concepts among entrepreneurs, the Association today has only a few members. Main activities of the Association have been based around promoting and advertising franchise opportunities in various media and the co-organization of an international forum Franchise and Partnership Expo in Zagreb. Over the past few years (2003-2006), this event comprised of regular franchise conferences with a number of domestic and international experts in different aspects of franchising (bank representatives, lawyers, university professors and the representatives of major franchisors) as guest speakers and participants.

However, the number of exhibitors on Croatian Franchise Forum declined over the last years (in 2003 there was 35 exhibitors; in 2004 – 29 exhibitors; in 2005 – 15 exhibitors), and the main cause for this is the size of Croatian market (4,2 million people) which is too small for large franchisors.

Other significant institution involved in franchise promotion in Croatia is The Franchise Center established within the Center for Entrepreneurship Osijek in 2003. The Center is focused on educating interested parties in the process of becoming franchisors and/or franchisees. Center for Entrepreneurship became a franchisee of The Franchise Center El Paso (established by the University of Texas at El Paso), and brought its seminar "The Big Picture" to Croatia. Working

²⁰ Croatian Franchise Association, <http://www.fip.com.hr/fipHr/index.asp?lang=hr>, May 20, 2007

materials used in this seminar have been adjusted according to legal and economic aspects of Croatian business practice and a new educational program "Franchise from A to Z" was developed. This seminar is held twice a year (spring and autumn) in The Franchise Center of Center for Entrepreneurship Osijek, and in the late 2006 USAID project "Entrepreneurial Croatia" co-financed the effort to bring the seminar to ten other Croatian cities. More than 200 potential franchisees and franchisors participated in educational programs of The Franchise Center. In addition to educational programs, The Franchise Center employees work as consultants and intermediaries in bringing together potential franchisors and franchisees in Croatia.

Besides the two institutions mentioned a forehand, there is also a privately-owned company "Promaturo – an entrepreneurial franchise center" which operates from Zagreb and offers agency services for a number of foreign franchisors interested in finding franchising partners in Croatia. Promaturo provides their clients with consultancy services in establishing franchise networks of Croatian companies and advises all the clients interested in becoming franchisees of an available franchise business.

4. Empirical Research “Franchising Development perspectives in Croatia”

4.1. Research Methodology

A research entitled “Franchising development perspectives in Croatia” was conducted in September 2006 by The Franchise Center of Center for Entrepreneurship Osijek. Over that period, “Entrepreneurial Croatia” – a USAID SME support project in Croatia, co-financed the visit of professor Ilan Alon who worked together with The Franchise Center representatives and held several workshops on franchising for:

- a) lawyers interested in providing consultant services to potential franchisors and franchisees;
- b) bankers interested in providing financial support for start-up entrepreneurs who start their business ventures as franchisees;
- c) consultants interested in providing counseling services for potential franchisees and creating franchise networks to promote franchising as a new business model for Croatian companies – potential franchisors.

Each of the workshops was followed by a survey where all the participants were asked to fill out a questionnaire designed to analyze the macro environmental factors influencing the development of franchising in Croatia. PEST analysis

(political, economic, social and technological factors analysis) was used for environmental scanning purposes and the questionnaire used in the survey can be found enclosed in Appendix 1. The total of 45 participants took part in the survey (15 lawyers, 15 bankers and 15 consultants).

4.2. “Franchising development perspectives in Croatia” – research results

The majority of survey participants agreed on two service-based industries with biggest potential of growth using franchise business model: tourism and hospitality industry.

Major operational challenges influencing the development of franchising, as identified by the survey participants, are: lack of legal regulation of franchising as a business model; slow justice system – interconnected with the mistrust of foreign franchisors and their lack of interest for entering into Croatian market; and the general lack of knowledge on advantages and opportunities of franchising as a new business model by all sides which could benefit from franchising development (bankers, entrepreneurs, support institutions, consultants).

Picture 1: Main operational challenges influencing the development of franchising in Croatia identified by the survey participants (bankers, lawyers and consultants)



Source: Research results - “Franchising development perspectives in Croatia”

Lack of awareness of franchise as a business model in Croatian business environment is highlighted as one of the major opportunities for franchise development by the majority of survey participants, while insufficient legal protection of franchisors' rights stands out as the most frequently mentioned threat. These and other opportunities and threats identified in the survey are shown in Table 8.

Table 8: Major opportunities and threats for franchise development in Croatia

	OPPORTUNITIES	THREATS
LAWYERS	<ul style="list-style-type: none"> ▪ development of the service industries sector; ▪ insufficient awareness of franchising as a business model 	<ul style="list-style-type: none"> ▪ lack of governmental and banking sector support; ▪ insufficient protection of franchisors' rights; ▪ frequent regulation changes; ▪ insecurity of conducting business and debt collection due to slow justice system
BANKERS	<ul style="list-style-type: none"> ▪ customers increasingly focus on quality service and quality control; ▪ market still not saturated by this business concept; 	<ul style="list-style-type: none"> ▪ slow legal system; ▪ low TEA index; ▪ mentality
CONSULTANTS	<ul style="list-style-type: none"> ▪ country in transition economy; ▪ incentives for franchise development; ▪ Croatia facing EU accession 	<ul style="list-style-type: none"> ▪ low attractiveness of Croatian market to foreign franchisors, ▪ lack of expertise and experts; ▪ Croatia facing EU accession ▪ lack of adequate knowledge

Source: Research results - "Franchising development perspectives in Croatia"

Survey participants were expected to identify major political/legal, economic, social and technological factors influencing the development of franchise as a business model in Croatia. All the collected answers were systematized and put in the matrix overview which shows the PEST analysis of the major environmental factors influencing franchise development in Croatia (Table 9)

Table 9: PEST analysis of the major environmental factors influencing franchise development in Croatia

<p>POLITICAL FACTORS</p> <ul style="list-style-type: none"> ➤ no registry of movables which could be used as a collateral; ➤ bureaucracy; ➤ insufficient protection of franchisors' rights; ➤ lack of legal experience in regulating franchise as a business concept; ➤ insufficient arbitration usage; ➤ possibility of sudden regulatory interventions by the legislators; ➤ franchise agreement non-existent in state regulations; ➤ inadequate intellectual property rights protection; ➤ lack of lawyers who are highly specialized and trained for franchise business model. 	<p>ECONOMIC FACTORS</p> <ul style="list-style-type: none"> ➤ Croatia is not recognized as a tax-friendly country; ➤ small market ➤ lack of public institution support (e.g. HAMAG) ➤ unwillingness of banks for participating in franchise purchase financing ➤ low purchasing power with relatively high franchise product/service prices ➤ insufficient economic development ➤ high unemployment rate ➤ lack of adequate financial tools
<p>SOCIAL FACTORS</p> <ul style="list-style-type: none"> ➤ mentality (infringements of business agreements, quick profit expectations) ➤ low standard of living ➤ lack of knowledge ➤ high indebtedness of the population ➤ atmosphere of mistrust ➤ intellectual property rights violations 	<p>TECHNOLOGICAL FACTORS</p> <ul style="list-style-type: none"> ➤ lack of adequate knowledge ➤ low R&D investment rates ➤ bad infrastructure ➤ low level of technological education ➤ underdevelopment ➤ technology obsolescence and low rate of new technology trends' adoption

Source: Research results - "Franchising development perspectives in Croatia"

Survey participants have made extremely positive forecasts on the development of franchising in Croatia with the accession to the European Union being identified as the development accelerator. Number of franchisors and franchisees will grow by 30-50% over the next 5-10 years. Participants anticipate bigger and faster growth of foreign franchisors in comparison to their domestic counterparts, with major franchise networks concentration in areas surrounding Zagreb, Split and Istria region.

Eye Optics Lens

Dubravka and Damir B. opened Eye Optics Lens – the first privately-owned optical retail in Osijek in late 1980s. After several years, they started to grow their business to eye glass manufacture and soon became fourth largest eye glass manufacturer in Croatia. Their business soon expanded to optician equipment distribution and servicing for a top-quality Japanese manufacturer and the exclusive dealership agreement for a broad geographical area. By optical equipment distribution and eye glasses retail and wholesale, they have established business contacts with a number of optical retail businesses in Croatia. They have received many inquiries by entrepreneurs interested in starting their own optical businesses. Dubravka and Damir have provided them with optical equipment, with tons of free information and advice on running their businesses and assisted them in establishing new business contacts. With 15 years of expertise in optical industry, they have decided to systematize their knowledge and try to offer it to potential buyers using franchise as a business growth model.

After the final decision of creating their own franchise network was made, they faced numerous challenges in the process of trying to bring their idea to life: potential buyer's market isn't sufficiently educated on the possibilities and advantages of franchising, there is a lack of legal experts with experience in dealing with franchise business concept, there is no legal framework established for this business model, and there are no financial products and services offered by the banking industry which would facilitate the growth of potential franchise market. After facing these challenges and realizing the current state of franchising in Croatia, Dubravka and Damir have decided not to follow up on their idea of franchise network development. They became aware that becoming a franchisor in Croatia today implies entering a brand new industry with their business becoming a product to sell to an insufficiently educated buyer's market with no actual demand and decided to return to their core business instead. Franchising as a business growth model will have to wait for better times in their case.

5. Conclusion

Franchising represents a business growth model with broad array of implementation possibilities in developed economies worldwide. Key advantages

of this business model lie in quick growth and expansion possibilities, risk minimization and lower investments, and its success derives from establishing and managing a healthy balance of mutual interests between the franchisor and the franchisee.

Franchising has been present in Croatia since late 1970s, but first real promotion of this business model brought McDonald's in 1990s. However, franchising in Croatia has somewhat stagnated on a rather low level which was interconnected with general economic situation, weak entrepreneurial climate and low level of innovation and competitiveness of Croatian companies. At the same time, there are only two franchise support institutions operating in Croatia – Croatian Franchise Association and The Franchise Center – part of Center for Entrepreneurship Osijek, both with the mission of promoting franchise as a business model.

Companies which today decide to expand their businesses by becoming franchisors in Croatia are facing legally non-regulated area, insufficiently educated potential franchisees and lack of adequate financing products and services for franchise purchase from the banking industry. Many of them, faced with these challenges, decide to give up their idea of growing their business via franchising (Lens Ltd. case), which leaves us with the total of between 25 and 30 Croatian franchisors operating currently in Croatia (unofficial information provided by Croatian Franchise Association), a significantly smaller number when compared to some other transition countries. The results of a research project “Franchising development perspectives in Croatia”, conducted in September 2006 with lawyers, bankers and consultants as target groups, indicate that Croatia will witness a major development of franchising as a business model over the next 5-10 years, with tourism and hospitality being touted as driving industries of franchising development.

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Appendix 1: Questionnaire used for the survey purposes in “**Franchising development perspectives in Croatia**” research

1. Which industries in your opinion show the biggest potential for growth by using franchise as a business model?
2. Identify the major operational challenges that, in your opinion, have the biggest influence on the development of franchising in Croatia.
3. Identify the major opportunities and threats for franchisors in Croatia.
4. Identify the major political and legal factors influencing franchise development in Croatia.
5. Identify the major economic factors influencing franchise development in Croatia.
6. Identify the major social factors influencing franchise development in Croatia.
7. Identify the major technological factors influencing franchise development in Croatia.
8. How do you see franchising as a business model in Croatia in the next 5-10 years?