

**NEAR EAST UNIVERSITY**



**FACULTY OF ECONOMICS AND ADMINISTRATION  
SCIENCES  
DEPARTMENT OF BUSINESS**

**DEVELOPMENT OF  
FAST-FOOD FRANCHISE IN TURKEY**

**&**

**MC DONALD'S**

**BY**

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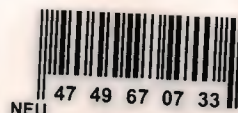
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**FEBRUARY, 2003**



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## **I. INTRODUCTION**

### **1.1. Objective of the Study**

In my graduation project the subject that I will try to inspect, analyze and present is the Developments of Franchising in fast-food sector in Turkey by taking the world's most famous franchiser Mc Donald's as an example.

The basic objective of this study is to reach the result that franchising is one of the best way for enlarging the business and prove the developments of this sector in fast-food industry in Turkey by the help of a world's giant Mc Donald's.

#### **1.1.1. Methodology**

While preparing this project the methodology that I followed is;

- contact with some Franchise Researcher Firms of Turkey (*IBSresearch, UFRAD*) by mail and phone to get detailed information about fast-food franchising in Turkey.
- visit *Mc Donald's General Office of Turkey in Zincirlikuyu/ISTANBUL* and interview with Nazila Özhan, the Head of Franchising Department of Turkey, to learn more information about the future of fast-food sector of Turkey.
- collect informations by web-sites of researcher companies and Mc Donald's from internet to find out information that will be useful about my project.



- after the contacts I made with IBSresearch and UFRAD(Franchise Researcher Firms of Turkey), I receive e-mails from them covering the statistical datas, graphs and general informations about Mc Donald's and the fast-food franchise sector of Turkey.

### **1.1.2. Introduction to Franchise in Turkey**

Essentially franchising is a very specific method or way of distributing goods and services. It has been around in one form or another since man first began to engage in commercial enterprise. It has evolved from a simple grant of a right or privilege in the middle ages to the sophisticated business format franchise concept of today.<sup>1</sup>

The market for fast food franchising in Turkey has grown dramatically since McDonald's entered as the country's first operation in 1986. Since then, the sector has experienced an influx of both foreign and local investment concentrated in the greater urban Istanbul area. As of December 2000, there were 180 fast food establishments operating in Turkey. Of those, 138 are located in the Istanbul vicinity, 9 are in Ankara, 4 in Izmir, 2 in Bursa, and others are scattered across smaller cities in the western part of the country. With a population of over 12 million that increases annually by about half a million, Istanbul is clearly the pulse of the fast food franchising market in Turkey.

McDonald's opened its first restaurant in Turkey on October 24, 1986 in Istanbul. Today there are 115 restaurants with 3,500 employees throughout Turkey.

Following McDonald's lead, other U.S. franchises have committed to investment in the sector and have generally found success in the Turkish market. U.S. based fast-food franchises in Turkey include McDonald's (98 restaurants), Pizza Hut (23 restaurants), Burger King (22 restaurants), Sicily's (12 restaurants), Arby's (11 restaurants), and

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<sup>1</sup> David J.Rachman, Michael H.Mescon, Courtland L.Bovee, John V.Thill, Business Today, Seventh Edition, New York, 1993, p.141

Kentucky Fried Chicken (7 restaurants). 7- Eleven currently operates 13 stores in Turkey, nine of which are located in Istanbul.

Other foreign fast food franchises have not entered the market with the exception of Wimpy (UK), which operates four restaurants in Turkey(2000). Local franchise competitors have shown more desire for growth in the market. Local Sutte offers deli- style foods and sandwiches, while Borsa Lokantaları, Mudurnu and Sultanahmet Köftecisi offer more traditional, Turkish style meat dishes. The largest of the local establishments, Sultanahmet Köftecisi, operates 18 restaurants, 17 of which are in Istanbul.

As all those informations on top implies, the expansion of the fast food industry in Turkey has largely resulted from a surge in the populations of the urban areas of the country and in the increased demand for western-style fast foods. Moreover, fast food restaurants are generally perceived as convenient family establishments in Turkey, especially those which include special facilities for children. McDonald's have capitalized on this attraction, having built playgrounds and party areas for children in Istanbul, a city which offers few facilities for children.

## **II. HISTORY**

### **2.1. History of Franchise**

The word 'Franchise' comes from old French meaning privilege or freedom. In the middle ages a franchise was a privilege or a right. In those days, the local sovereign or lord would grant the right to hold markets or fairs, to operate the local ferry or to hunt on his land. This concept extended to the Kings granting a franchise for all manner of commercial activities such as building roads and the brewing of ale. In essence the king was giving someone the right to a monopoly for a certain type of commercial activity. Over time the regulations governing franchises became a part of European Common Law.

Over the centuries the franchising concept has evolved as the economies of the nations of the world have evolved. In the 1840's in Germany certain major ale brewers granted franchises to certain taverns, giving those taverns the exclusive right to sell their ale. This was the beginning of the concept of franchising as we know it today. In 1851, the Singer Sewing Machine Company began granting distribution franchises for their sewing machines. Singer had written franchise contracts which were the forerunners of modern franchise agreements. In the 1880's cities began to grant monopoly franchises to street car companies and utilities for water, sewerage, gas and later electricity.

Around the turn of the century, the oil refinery companies and the automobile manufacturers began to grant the right to sell their products. At this stage in the evolution of franchising it was essentially just the granting of the right to distribute and sell a manufacturers products.

Business format franchising<sup>2</sup>, which is the dominant mode of franchising today came onto the economic scene after World War II with the return of the millions of US

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<sup>2</sup> See appendix 1.1.



servicemen and women and the subsequent baby boom. The baby boom is still driving the economy and will continue to do so into the next century. There was an overwhelming need for all types of products and services, and franchising was the ideal business model for the rapid expansion of the hotel/motel and fast food industries. During the explosion of the 60's and 70's there were many abuses in franchising. There will always be the unscrupulous con men/women among us, ready to prey on the uninformed and gullible. There were a number of totally fraudulent franchise companies which literally took peoples money and ran, and there were a number of companies that were undercapitalized and poorly managed which went bankrupt, leaving a trail of failed franchisees who lost everything.

There are several franchisee associations which work to protect the interests of franchisees.

Today, franchising is a highly regulated industry which offers a great opportunity to those individuals who truly want to realize their dream and go into business for themselves.

## **2.2. Historical Background of Mc Donald's**

In 1954, Ray Kroc discovered a small hamburger street vendor in San Bernardino, California, named McDonald's. 46 years and over 24,000 restaurants later, McDonald's is now an international empire, with units in 116 countries including Turkey, Brazil, Australia, Japan, Egypt, Kuwait and Finland on the Arctic Circle. In short, McDonald's is the largest and most popular fast-food hamburger chain in the world.

In fact, McDonald's is the largest franchise in any industry in the world. They are first in worldwide sales and number of locations. Only 7-Eleven has more units internationally. They have been an industry leader for several decades and, with the depth



and experience this company has, they will have considerable staying power for some time to come.

*Raymond Albert Kroc 1902-1984*, A Salesman Ray Kroc mortgaged his home and invested his entire life savings to become the exclusive distributor of a five-spindled milk shake maker called the Multimixer. Hearing about the McDonald's hamburger stand in California running eight Multimixers at a time, he packed up his car and headed West. It was 1954. He was 52 years old.

Ray Kroc had never seen so many people served so quickly when he pulled up to take a look. Seizing the day, he pitched the idea of opening up several restaurants to the brothers Dick and Mac McDonald, convinced that he could sell eight of his Multimixers to each and every one. "Who could we get to open them for us?" Dick McDonald said. "Well," Kroc answered, "What about me?". Then the *Mc Donald's adventure began*, in Des Plaines, Illinois Ray Kroc opened the Des Plaines restaurant in 1955 and first day's revenue of this adventure is \$366.12!

Today, Mc Donald's is the largest, best-known franchiser and global foodservice retailer with more than 30,000 restaurants in 121 countries. Mc Donald's serves less than one percent of the World's population. There are many strong competitors in the fast food industry. Some of them are: KFC, Burger King, Pizza Hut, Domino's Pizza ... etc. and now Mc Donald's is the leader of the industry.

And the key to their success is;

**'Franchising'**. Local people franchise around eighty percent of golden arches, and by doing so, McDonald's are able to overcome cultural barriers that have previously hindered other organizations. Because these local people immediately translate both the product and service, there is little hint of what may be construed as US brand culture. McDonald's basic success philosophy is *'Think globally, act locally'*.

Mc Donald's catch their success and attract people for franchising by the help of their brand recognition, experienced management, high-quality food, site development

expertise, and advanced operational systems; with the help of some strategies as product development, market development, forward integration, alternative locations, and joint venture.

McDonald's opened its first restaurant in Turkey on October 24, 1986 in Istanbul. Today there are 115 restaurants with 3,500 employees throughout Turkey now and plans 25 more restaurants throughout the country by the end of 2004.

### III. MC DONALD'S AND FRANCHISING

McDonald's has always been a franchising company and has relied on its franchisees to play a major role in its success. McDonald's remains committed to franchising as a predominant way of doing business. Approximately 70% of McDonald's worldwide restaurant businesses are owned and operated by independent owners.

Operating Units	12/31/97	12/31/98	12/31/99
Franchised	10,648	10,732	10,789
% Change	3.3%	0.8%	0.5%
Company-Owned	1,827	1,850	1,838
% Change	-3.0%	1.3%	(-0.6)
Total *	12,475	12,582	12,627
% Change	2.3%	0.9%	0.4%
Franchised as % of Total	85.4%	85.3%	85.4%

**Table 1.1.** Statistics of all Mc Donald's Restaurants in the World.<sup>3</sup>

Mc Donald's franchising system is built on the basis that the Corporation can be successful only if their franchisees are successful first. They believe in a partnering relationship with their owner/ operators, suppliers and employees. Success for McDonald's Corporation flows from the success of its business partners.

The selection of Mc Donald's is based on an assessment of overall business experience and personal qualifications. They look for individuals with good "common business sense", a demonstrated ability to effectively lead and develop people, and a history of previous success in business and life effort. A restaurant background is not

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<sup>3</sup> Source of Table 1.1. is internet site of Mc Donald's. [www.mcdonalds.com](http://www.mcdonalds.com) (1999)



necessary. They franchise only to individuals, not to corporations, partnerships, or passive investors.

The McDonald's franchise agreement<sup>4</sup> allows the franchisee to operate a specific McDonald's restaurant, usually for a period of 20 years, according to McDonald's standards. McDonald's locates, develops and builds the restaurant under its own direction based on a nationwide marketing plan. The local franchisee equips the restaurant at his/her own expense with kitchen equipment, lighting, signage, seating and decoration. This investment differs from restaurant to restaurant. Only individuals can qualify for a franchise. McDonald's does not grant franchises to corporations or partnerships and does not allow absentee investors.

McDonald's states that they are looking for aggressive risk takers willing to operate as a contributing partner to a demanding organization. McDonald's seeks:

- Turkish citizenship and local residence;
- Entrepreneurial spirit and a strong desire to succeed;
- Strong business background with emphasis on people-related skills and financial management;
- Willingness to personally devote full time and best efforts to the day-to-day operation of the restaurant as an on-premises owner/operator;
- Willingness to participate in training and evaluation programs, provisionally lasting eight months on a full-time basis.

Presently, 97 percent of McDonald's raw materials are sourced from Turkey. The firm has two American suppliers established in Turkey: Eastbalt (a recent investment of \$3.5 million) producing bread; and a U.S./Turkish joint venture, Lamb-Weston/Dogus, producing potatoes. Both suppliers also export about \$10 million worth of their products annually from Turkey to several countries throughout the world.

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<sup>4</sup> See appendix 1.1.



Since importation of beef to Turkey has been banned, McDonald's is assisting U.S. firms wishing to enter the Turkish market for meat production.

A major factor in developing McDonald's units in Turkey are costs not found in all countries, particularly the costs imposed by Turkey's extensive tariffs and non-tariff import barriers. As noted above, importation of beef is banned, and there are major costs imposed on other basic products such as chicken, potatoes and equipment. While the firm hopes to develop alternative sources of supply, McDonald's intends to focus on the natural cost advantages to be attained through a strategy of global purchasing. Without trade barriers, each country could take advantage of its natural strength in producing particular commodities and products.

According to a Franchise Manager of McDonald's Turkey operation, initially a franchise will need to import some products, but as it grows it will increase its domestic purchasing. When its purchases of each product reach to a certain level, it turns to domestic sources, encouraging them to expand, become more efficient, and compete with imports.

The expense for opening a Mc Donald's franchise includes rent, inventory legal fees, equipment, insurance, and licenses. These amounts are 10 times more than the start-up fee and they can reach sometimes more than \$500,000-\$600,000 related with the size of building, etc.

Item	Established Low Range	Established High Range
Franchise Fee	\$45,000	\$45,000
Equipment/Signs/Décor	\$397,000	\$506,650
Inventory/Supplies	\$12,000	\$22,000
Additional Start-Up Funds	\$20,800	\$66,500
Total Investment *	\$477,800	\$1,401,150

**Table 1.2.** Investment Required For Start-Up a Mc Donald's

\*Does not include optional improvements of \$530,000–641,000 and estimated 3 months rent of \$3,000–120,000 (depending on building size and location).<sup>5</sup>

<sup>5</sup> Source of Table 1.2. is internet site of Mc Donald's. [www.mcdonalds.com](http://www.mcdonalds.com) (2000)

### **3.1. Fast-Food Market Profile of Turkey**

There is no real competition for American fast-food technology and management, although local competitors are often successful in the market because they cater to local tastes and offer lower prices. U.S. franchises cater mainly to the upscale population and the youth of the country (about 60 percent of Turkey's population is aged 25 years or less), who have "modern" tastes and are receptive to American products. U.S. brand recognition is strong.

Most U.S. fast food franchises with a presence in the Turkish market have long-range plans for expansion. Both McDonald's and KFC, for example, have 7-10 year plans for multiple restaurant openings in urban areas. In general, prospects for growth in this sector are very positive based on the growth of the Turkish economy and consumer tastes.

Generally the market for franchise operations is concentrated in the major cities&centers such as Istanbul, Ankara, Izmir, Adana, and Bursa.

Turkey shows an uneven income distribution in the country's various provinces, and the gap between urban and rural, as well as eastern and western, per capita income levels. For example, the most industrialized northwestern province of Kocaeli averaged \$7,900, while the eastern province of Ağrı averaged \$750. So, this economic effects forces growth of the population from rural areas to urban centers.

Turkey also has a large and growing middle class. Most of the relatively high-income customers of foreign franchises are quality-conscious, and they favor well-known brands in all sectors.

Also there is no real competition for American fast-food technology and management, although local competitors are often successful in the market because they cater to local tastes and offer lower prices. U.S. franchises cater mainly to the upscale

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### **3.2. Industry Analysis of Fast-Food Franchising in Turkey**

Turkey's geographic position between the Middle East and Europe gives it a unique character. Its dynamic economy, its population of more than 60 million, and its young and ambitious entrepreneurs, make it an attractive market for franchisors around the world.

The franchise system first entered to the markets in Turkey in 1986 and McDonald's is the first foreign franchiser which entered Turkey. After that the sector has grown to nearly 200 franchisors, and over 4000 franchisees. About one third of these franchisors are foreign companies. The estimated total turnover of franchising units in Turkey at the end of 1998 was about \$900 million, and this represents an increase of 85 percent over 1997. Foreign franchises account for approximately half of this turnover.

Factors positively affecting the development of franchising in Turkey are:

- the high demand in private entrepreneurship in partnership with foreign firms among the younger generation, in response to the government's encouragement of foreign capital and obvious benefits of owning one's own business;
- the development of the leasing concept as a suitable means of financing small and medium-size enterprises;
- the increased interest in Turkey by foreign franchisors, not only because of Turkey's own attractions as a lucrative market, but also for its increasing significance as a stepping stone to Central Asian markets;
- legislation which recognizes franchising as somewhat different from ordinary foreign investment, and grants certain legal exemptions to franchises. The Block Exemption' decree of December 1998, based on the European Community's Law No. 4087/88, grants franchise investments exemption from the law on Free Competition. This frees franchise operations from stipulations contrary to the operation of a franchise.

Although foreign franchises are still concentrated in fast foods and apparel, the sector is diversifying rapidly into other areas such as education, cleaning, printing, office

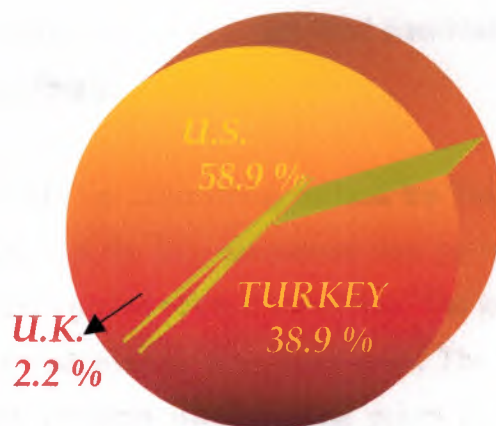


and computer services, furniture, hardware, real estate, stationery, fitness, and supermarket chains. Service companies are expected soon to outnumber fast food and apparel franchises.

Local franchisors, in return, have begun selling their franchises abroad as well as domestically.

The United States has the largest share of the Turkish market among foreign franchises.

**2000's Foreign Fast-Food Franchise shares in Turkey:**



**Figure 1.1.** Foreign Fast-Food Franchise shares in Turkey (2000) <sup>6</sup>

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<sup>6</sup> Source of Figure 1.1. Turkish Franchising Association (Dec.2001)

### **3.2.1. Competitive Analysis of Fast-Food Industry in Turkey**

Major competitors of U.S. fast food franchises are primarily local eating establishments. There is still a core percentage of the population which frequents local, traditional "diner" type restaurants which offer basic Turkish fare at low prices. It is difficult for U.S. franchises to lure this segment of the market into choosing American establishments because of force of habit and noncompetitive pricing.

Pricing is a sensitive issue for U.S. suppliers in Turkey. Restrictions and/or duties placed on imported products are a great hindrance and cause expenses to rise significantly. Strict food import restrictions do not allow meat importation into the country. McDonald's has stated that beef prices in Turkey are a whopping 400 percent higher than they are in the U.S., which naturally forces U.S. fast food franchises in the country to raise their prices to consumers accordingly.

McDonald's has aggressively lobbied the Turkish government to allow beef imports into the country, but the only compliance thus far received has been a temporary lifting of the ban for a short period of experimentation. The government has no future plans to allow beef to be imported, even in exceptional cases. The biggest challenge for U.S. franchises is to offer quality products while keeping prices at the lowest levels which will maintain profits. McDonald's stated that currently 45 percent of all costs to run their operations in Turkey consist of food (mainly meat) products.

Local competitors offering traditional Turkish fare have the benefit of serving mainly lamb-based dishes, a meat which is cheaper than beef and more plentiful because of local tastes in the country. However, consumer tastes are beginning to change in the urban areas of the country, especially regarding meat preferences. Chicken consumption in Turkey has risen significantly in the past several years, and is expected to continue to rise in the next decade. All five of the major U.S.- based fast food franchises in the country offer chicken menus.

Of the existing franchisees numbering around 4000, most are upper-income, young urban entrepreneurs. About a quarter of the franchisees of foreign franchisors are women aged between 30 and 40. Educated women who wish to break the traditional subordinate roles in the business world are increasingly turning to franchise operations to prove their independence and business abilities. Especially in the apparel sector, most franchisees are young women with university educations.

Inside all the existing franchises in Turkey, the largest share of foreign franchises are in the fast food and apparel sectors. The application of franchising is diversifying rapidly as the advantages of the concept become more widely known.

#### **Best Sales Prospects in TURKEY:**

Well-known brand names in Turkey in the following areas have the best sales prospects:

- Restaurants or cafes (not necessarily fast' foods)
- Multi-level communications systems and interactive web page services
- Entertainment centers
- Children's and toy shops or toy brands
- Hardware operations
- Sports facilities
- Supermarkets
- Fashion boutiques

### 3.2.2. Ratios Related with Franchises in Turkey by Comparison

<i>Statistical Data on Franchises (in Turkey)</i>			
	<u>1998</u>	<u>1999</u>	<u>2000</u>
<i>Foreign Franchises (U.S. and others)</i>	450	600	750
<i>Local Franchises</i>	450	700	1000
<i>Total Market</i>	900	1300	1750
<i>Turkish Franchises Abroad</i>	50	100	150
<i>U.S. Franchises</i>	300	400	500

**Table 2.1.** Franchises in Turkey by comparison <sup>7</sup>

<sup>7</sup> Source of Table 2.1. UFRAD, Turkish Franchise Association (2001)



### **3.2.3. Competitive Situation between Franchisors in Turkey**

#### ***Foreign Competitors of U.S. Franchisors:***

Jimmi's Fried Chicken (U.K.), Wimpy (U.K.), Duran Sandwiches (Austria), Bata Shoes (Italy), Premaman pregnancy and baby products (Belgium), Chicco children's shops (Italy), Gazellini apparel (Italy), Lee Cooper informal apparel (U.K.), MEXX apparel (Holland), Mothercare children's apparel (U.K.), Mustang Jeans (Germany), New Man apparel (France), Roberto Lenzi shoes (Italy), Sergio Tacchini sportswear, accessories and shoes (Italy), The Magic Touch promotional/textile printing and copying services (Germany), Euro Barter Business international bartering services and consultation (Austria), Nectar Beauty Shops (U.K.), Sonax automotive maintenance (Germany), Vit-Net Dry Cleaning (France), Mr. Bricolage building materials/DIY products and hardware (France).

#### ***Turkish Competitors of U.S. Franchisors:***

Hacioglu (Turkish-style pizza-type fast food), Motta Gida (bakery), Mudurnu Pilic (raw and cooked chicken), Pizza Days (Italian food), Sagra Special (hazel nut and chocolate products), Sampi (Black Sea food), Tadim Pizza, Asli Borek (Turkish pastry), Burgy's (fast food chain), Casita Caf Restaurant (Turkish food), Domino's Pizza, Emin Pastaneleri (bakery), Fan Fang (Chinese food), Iskender (doner kebab: a special Turkish meat dish), Kocatepe Kahve Evi (all types of coffee), Mado Dondurma (ice-cream), Pizzamatik, Tamet (meat products and fast food restaurant), Sultanahmet Halk Koftecisi (meatballs), Ceylan (children's apparel), Linda (home textiles), Melike Zeynep (home textiles), Ayakkabi Dunyasi (shoes and hats), Beymen (apparel and all types of textiles), Cembalo (children's apparel), Cukurova T.A.S. (home textile products and apparel), FBI – Geteks (apparel), Infinity Design (ladies' apparel), Karaca (knitwear and other apparel), Romans (home textiles), Silk & Cashmere (high-quality apparel), Sporting (sportswear),

ASE International (hand-to-hand international courier service), Birlesmis Emlakciler-BETAS (real estate marketing and consultancy services), DEULCOM International (education and training), NET Barter (barter transactions), Pimapen (PVC window systems), Ya-Pa (children's publications and toys), Aqua (bottled drinking water), Communication Center (communication, mail, cargo, courier and internet services), Cleanvac (home and industrial cleaning machinery), Happy Kids (computer-aided pre-school training seminars), Kenitex (exterior coatings, floor coverings, waterproofing materials), OTA Slim Center, Okotek natural products and cosmetics), Professional Hotel Services (cleaning, chauffeur, security and other services), Terminix International (insect control systems), The Club (sport facilities), Turyap (real estate marketing services), Zumrut/Yakut/Inci (coal production and distribution), Aidata Computer Shop (computer and peripherals sales and services), D&R (music CD and cassette, book/magazine, computer products, hobby and giftware sales), Kervan (home textiles), Escort Computers, Raksotek (music and multimedia products and services), Spectrum Office Superstore, Casper (computer-related services), Demsas (kitchen and bathroom furniture), Dunya Genclik Merkezi (giftware and hobby products for young people), Gorbon Isil (ceramic articles), Interlink (catalog sales of computers, furniture, sportsware, electronics, cosmetics and stationery), Ipek Mobilya (furniture), ISMAR (retail sales of food items), Jumbo (cutlery and kitchenware), KVK (mobile telephone services), Mopak (paper products such as notebooks, photocopy, fax and computer paper), Poly (electronic articles, fax, phone, answering machine and calculator sales), SERAY (beds and couches), BELLA (stationery), TEPE Furniture, Teknogon (supermarket equipment).

#### ***U.S. Franchisors in the Turkish Market:***

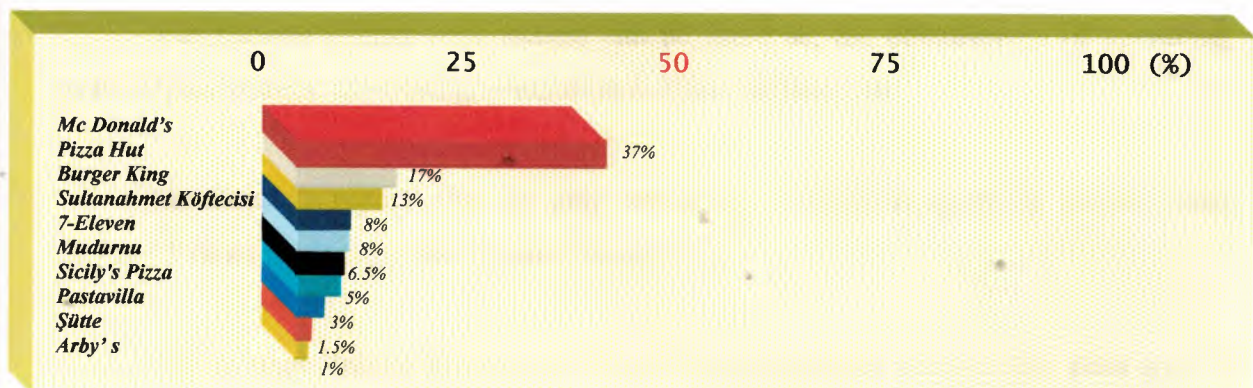
Alphagraphics (printing), El-Torito (fast food), McDonald's, Pizza Outlet, Schlotzsky's Deli, Subway, Burger King, Jenny's (50's-style diner chain), Sicily's Pizza, Dexter (shoes), Levi's Jeans, Mail Boxes etc. (mailing, cargo and communication services), Nutra Slim, Re/Max (real estate marketing), Ziebart Tidy Car (auto cleaning and maintenance), ExecuTrain (computer and technological training), Futurekids (computer training for children), Kwik Kopy Printing, ServiceMaster (professional home and office



cleaning services), Office 1 Superstore (office supplies), Dunkin Donuts, Pizza Hut, TGI Friday's (restaurants), 7 Eleven (fast food and consumer market), Wendy's (hamburgers and other fast foods).

**Top Ten Fast-Food Franchises Operating in Turkey:**

1. McDonald's (U.S.)
2. Pizza Hut (U.S.)
3. Burger King (U.S.)
4. Sultanahmet Köftecisi (Local)
5. 7-Eleven (U.S.)
6. Mudurnu (Local)
7. Sicily's (U.S.)
8. Pasta Villa (Local)
9. Şütte (Local)
10. Arby's (U.S.)



**Figure 1.2.** Top Ten Fast-Food Franchises Operating in Turkey<sup>8</sup>

<sup>8</sup> Source of Figure 1.2. Turkish Franchising Association (Dec.2001)

### **3.2.4. Economic Situation in Turkey**

Mc Donald's has an important role in the Turkish economy as in the whole world. Mc Donald's provide this positive effect on the economy by its sales volume and the system which they are in relation with many other sectors. Mc Donald's is the customer of manufacturers, lawyers, architects, finance accountants, advertising&human relations agencies, engineers, etc. In the countries they operate; and they share their knowledge, techniques and experience with those people. For example information in; food technology, production, packaging, delivering, etc. are some of techniques areas which they share.

The location of Mc Donald's in Turkey brings many investments from foreign countries to Turkey which Mc Donald's have rooted-relations. This condition provides flow of foreign capital from outside, new export opprotunities and transportation of new technological developments in different sectors for Turkey.

The other important positive effect of Mc Donald's in Turkish economy is the 'employ' of employees. By 115 restaurants and 3500 employees, Mc Donald's is not only an employer also an educator with the knowledge they give to their customers.

The reasons related with success can be listed as; the effectiveness of operating, technological efforts, advertising, promotional efforts, policies, etc.

Mc Donald's reports that the only competitor for them is again Mc Donald's and they are 3-times bigger than their nearest competitor.

The average annual growth of Turkey's gross national product has been over 5 percent since 1981, although there have been rises and falls depending on the general economic scene. Although in 1997 the GNP increased by 8 percent and totaled \$196 billion. Growth slowed in 1998 to 3.8 percent after the financial crisis in Russia, and is expected to fall to negative figures in 1999, in part because of the devastating earthquake



which struck Kocaeli in August 1999. Most analysts see the economic shrinkage of 1998u1999 as temporary, and expect a return to robust growth.

Turkey's most chronic economic problem is inflation. Consumer prices increased by 80 percent in 1996, and 99 percent in 1997. Despite government price controls and a tight monetary policy, inflation lingered at 85 percent in 1998. The figures for 1999 are more optimistic, with inflation falling to around 50-60 percent per annum, the lowest in more than a decade.

The economic reforms of the last decade reduced the central government's regulation of the economy. Turkey's private sector is now a key part of economic production, but the central government continues to damage economic progress through bureaucratic red tape and frequently changing policies. Government budget deficits and the market's lack of confidence in the government has caused the government to borrow high-cost money for short terms, thus raising interest rates further.

The Government's necessary economic reform steps include: an improvement of social security and subsidy programs; better tax administration; and privatization of state economic enterprises which are a heavy burden on the budget.

On January 1, 1996, Turkey joined the European Customs Union, eliminating duties on imports of most industrial products and processed agricultural goods with the EC. Turkey also adopted the EC's Common External Tariff, resulting in lower duty rates for third countries like the United States. Under this agreement Turkey has harmonized most of its commercial laws and regulations with the European Union.

Turkey is a member of the World Trade Organization and has signed a free trade agreement with the European Free Trade Association. It also has free trade agreements with Israel and many Central and Eastern European countries.

### 3.2.5. Political Situation

The United States has close political, military, economic and cultural ties with Turkey. The U.S. Government regards Turkey as a key player in all regional issues. Turkey itself remains against U.S., supporting policies that in some cases have caused it economic hardship, such as the Iraq embargo. The American sentiment of many Turks means wider acceptance of U.S. goods and services.

Because of Turkey's important regional role and close ties with many neighboring Turkish states to the East, *franchises* may benefit from the potential of these emerging Central Asian markets.

### **3.3. Situation of Mc Donald's in Turkey and in the World**

Starting from 1955, Mc Donald's always protect its profitability by being the best international franchiser company. But nowadays they started to decline in their sales volume and face with deficits. In the past 3 months period(July, August, September'2002) they have deficit of 343.8 million dollars.

One of the reason for this decline is the 'price-lowering action' of Mc Donald's against its nearest competitor Burger King. At the beginning Mc Donald's think to overcome this big problem by lowering their prices, but this effect them oppositely as a result of their fast-grow policy.

Another effect for the decline in sales of Mc Donald's is the 'madcow' illness which explode in Europe in the previous years. This disaster in food-sector broke the confidence of consumers againnst meat-products of Mc Donald's and this causes also a decrease in the sales volume in Europe. In USA, some other situation happens with the customers in recent years is the declining food&service standards of Mc Donald's. This condition effects the sales of the world hamburger leader in a big deal. As a result of bad situations in Europe and USA which are the largest market of Mc Donlad's, most important currency of income 'dollar' also declines.

The other important and basic reasons for the decline are bad-economic conditions and crises in world economy. As every sector in the world effected from this economic crises, Mc Donald's also take its share from this.

Mc Donald's as a result of all those reasons faced with some difficulties and reported their decline in sales volume and profit after 47 years.

In order to fight with all those factors for declining, Mc Donald's take some protective actions like closing 175 restaurants and fully recede from some foreign countries in Latin America and Middle-East, and for the better control of costs and resources by



eliminating 400-600 job positions. By those savings Mc Donald's targets a higher spending on strategic technology in 2003.

All the reasons for the decline in sales volume for Mc Donald's is also valid for Turkey like economic crises, etc.

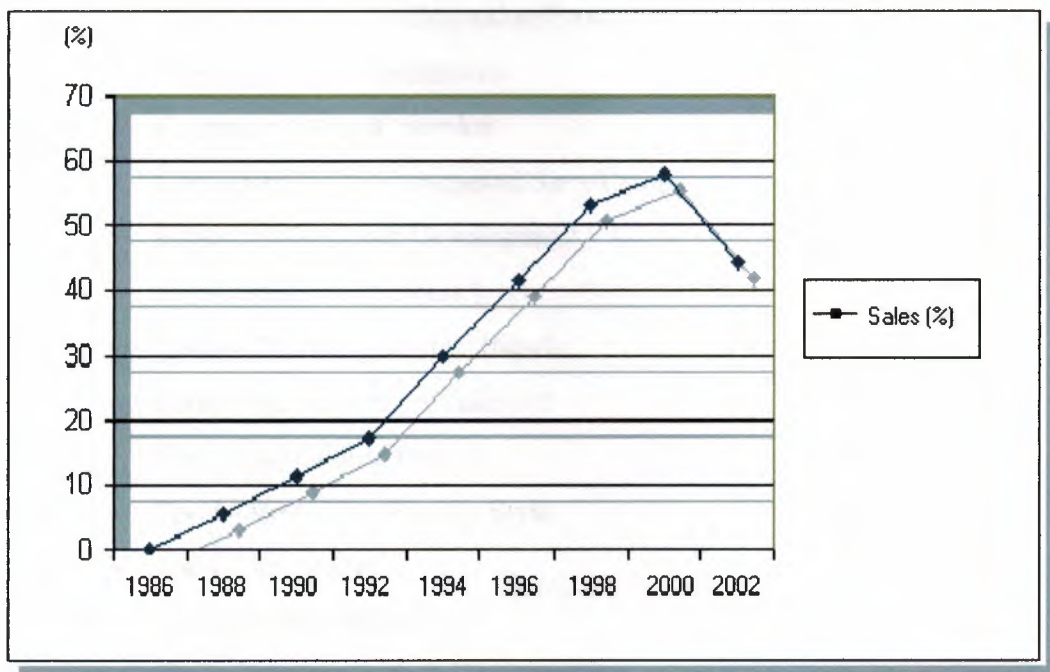


Figure 1.3. Sales of Mc Donald's in Turkey(2002) <sup>9</sup>

<sup>9</sup> Source of Figure 1.3. Turkish Franchising Association (Dec.2002)

### **3.4. Franchise Categories Around the World**

- Accounting/Credit/Collections
- Advertising & Promotion
- Automotive Products & Services
- Building Maintenance/Cleaning/Inspection
- Building & Remodeling
- Check Cashing/Protection
- Child Development/Education/Products
- Clothing/Shoes/Accessories
- Computer Sales & Service
- Convenience Stores/Supermarkets/Drugs
- Education/Personal Development - Adult
- Employment & Personnel
- Food - Donuts/ Cookies/ Bagels
- Food - Quick Service/Take-out
- Food - Ice Cream/Yogurt
- Food - Restaurant/Family Style
- Food - Specialty
- Health/Fitness/Beauty
- Home Improvement & Hardware
- Laundry/Dry Cleaning
- Lodging
- Packaging/Mailing
- Pet Products/Services
- Photography Products/Services
- Security/Safety Systems
- Signs
- Sports/Recreation & Entertainment
- Travel
- Video/Audio/Electronics

### **3.5. International Franchising**

The U.S. has experienced an explosion in business format franchising in the last two decades. There are a number of underlying reasons for this explosion but the primary reason is that franchising is the most efficient business model for distributing goods and services and the very advanced U.S. free market economy rewards efficiency above all. With the fall of communism and the move away from socialism and towards free market economies, throughout the world, franchising will explode all over the world as we move into the 21st century. The former communist bloc countries, the Pacific Rim and South America will experience rapid growth in franchising.

U.S. based franchisers who have a very solid, highly systematized concept with strong management, have the opportunity to have more units and generate greater gross sales internationally than they presently have and generate domestically. The international opportunities for excellent U. S. based franchise companies are virtually unlimited.

Along these same lines there are great opportunities for international entrepreneurs to bring U.S. based franchises to their home markets. U.S. franchisors want to expand internationally but need strong master licensees in the host countries that have the capital, business acumen and knowledge of these local markets to make the franchises successful.



### 3.6. Important Issues Related with Mc Donald's

- ✓ For opening a Mc Donald's restaurant the minimum investment required is as follows;

Franchise Fee.....	45,000
Equipment/Décor.....	397,000
Inventory/Supply.....	12,000
Additional Start-up Funds.....	<u>20,800</u>
<b>TOTAL INVESTMENT.....</b>	<b>\$ 477,800</b>

- ✓ Mc Donald's restaurants pay monthly salary, advertisement and marketing percentage payment.
- ✓ Before and after opening a Mc Donald's restaurant there would not be any financial support. The franchisee should cover all of his/her expenses by his/her own.
- ✓ Franchisee takes the help of Mc Donald's system in his/her first franchising of Mc Donald's. But in opening the second franchise restaurant, the franchisee should show his/her ability of educating, controlling and managing, etc. because this will become a criteria in opening second restaurant .
- ✓ Also there are 3months rent payments between 3,000-120,000 according to the building size, location, etc.
- ✓ Qualifications expected from Mc Donald's from franchisee's are;
  - High personal integrity
  - An entrepreneurial spirit and strong desire to succeed
  - A proven ability to motivate and train people

-The ability to manage finances

-A willingness to personally devote full time and best efforts to the day-to-day operation of the restaurant as an on-premise owner-operator

-A willingness to complete a comprehensive training program and become proficient in all aspects of operating a McDonald's restaurant business

-Financial resources

✓ How much does a McDonald's franchise cost?

New restaurant costs range from 455,000 to 768,500 USD. The size of the restaurant facility, area of the country, pre-opening expenses, inventory, kitchen equipment, signage, and style of decor and landscaping will affect new restaurant costs. These costs are paid to suppliers. In addition, at the time of opening, an initial fee of 45,000 USD is paid to McDonald's Corporation for all new restaurants

✓ How much cash (or liquid assets) is required to acquire a franchise?

The initial cash investment is a minimum of \$175,000 for a conventional purchase or \$100,000 for a Business Facilities Lease .

✓ Will McDonald's finance the remaining balance of the cost of the franchise?

No. McDonald's does not provide any financing. The remaining cost may be financed through a bank

✓ In a limited number of cases, McDonald's grants a Business Facilities Lease (BFL) franchise to candidates who excel in all qualifications but are unable to meet the financial requirements of the conventional franchising program. An individual must have a minimum of 100,000USD of non-borrowed personal resources to be considered for a franchise under the BFL program.

✓ The franchisee selection process of Mc Donald's does not play a part in their site selection. They develop a location because they think it will be successful. McDonald's does all of the site evaluation and selects the location. Mc Donald's

acquire the property, improve the site and construct the building. The franchisee is responsible for equipping the facility with all necessary items of kitchen equipment, seating and decor, signs and landscaping, etc. As sites are developed, Mc Donald's offer franchisees to candidates who have already completed training and are approved to become owner-operators. .

- ✓ The amount of money that a franchisee's restaurant should make, or profitability varies depending upon a number of factors, including sales, location, occupancy and operating costs and the ability of the franchisee to manage and control the business.
- ✓ Also; because Mc Donald's do not franchise restaurants to partners or investors, a person who wants to open a franchise should not obtain the funds of a relative, friend, etc.
- ✓ Mc Donald's have 30,000 restaurants in 121 countries around the world.
- ✓ Around the world Mc Donald's have 395,000 workers in and out of staff.
- ✓ The sales volume of Mc Donald's around the world is \$ 10.5 billion per year.
- ✓ In Turkey Mc Donald's have 115 restaurants with nearly 3,500 workers.



### **3.7. Future of Franchising in Turkey**

The growth of franchising is inevitable in Turkey, because of the inescapable logic of the underlying concept. Franchising clearly offers aspiring, new business owners the best possible chance of succeeding with the least risk. Within a decade or less, franchising will comprise over 50% of the retail economy, will employ millions of people, and will enable hundreds of thousands to realize the Turkish dream of successful business ownership.

As the Turkey's economy grow with the ever increasing populations, and the move toward free market economies, new franchise concepts will come on the scene and the solid, well managed existing franchise companies will continue to grow.

There is a move toward better protection of franchisee rights and over time this will push more franchisors towards structuring their relationships with their franchisees in a totally win/win manner. Franchising is evolving, it's getting better conceptually and in reality. There are greater opportunities for wealth creation among both franchisees and franchisors today then ever before.

The future of franchising is as bright as the sun and if you want to take the big step and go into business for yourself or if you have an existing business that you want to optimize, then you should look closely at franchising as the vehicle to take you to where you want to be in the 21st century.

## CONCLUSION

In conclusion the global business world companies now try to enter and expand themselves by entering into the business entity 'Franchising' and related with this increasing their success in their operating-life, gain advantages toward others, be well-known by everyone and maximize their profit. But the franchisor companies will have to fight to increase and keep their shares in the market because of the bad economy in Turkey.

Mc Donald's is now the leader of franchising sector both in Turkey and on the whole world. They are the leader and up today no other company could catch Mc Donald's. Their key success for being always number-1 is their well-usage of this important business concept 'franchising'. Addition to this, Mc Donald's success over the world depends on their efficient philosophy 'Think global, Act local'.

In today's Turkey the system of franchising is now one of the best growing sector and the future of franchising seems bright. The datas show that in the fast-food franchising market of Turkey, United States has the largest share at this moment.

The market for fast-food franchise operations of Mc Donald's and other fast-food franchisers operations in Turkey is generally concentrated in the major cities&centers such as Istanbul, Ankara, Izmir, Adana, and Bursa. Thus Turkey shows an uneven income distribution in the country's gap between urban and rural, as well as eastern and western, the per capita income levels changes. The Franchise Manager of McDonald's Turkey, Nazila Özhan, defines this unlucky situation with the low incomes of people in rural areas in Turkey and with the geographical position of them in basic. So, this economic effects forces growth of the population from rural areas to urban centers.

As Turkey's economy continues to grow with the ever increasing populations, and the move toward free market economies, new franchise concepts will born and as a result of that well managed existing franchise companies such as Mc Donald's will continue to grow.

## RECOMMENDATIONS

In general the view of fast-food industry now in Turkey seems to continue it's fast and huge growing.

Mc Donald's can continue on it's basic and successful strategy 'Think global, Act local' and by developing new products or new menu options like they did 'Köfteburger, Ayran, etc.' which are traditional and special for Turkey, they can keep their position in Turkish fast-food industry.

As a result; I don't think that there is so much thing can be said for Mc Donald's fast-food franchising for Turkey. Of course, the reason for this is the success of being the 21th centuries number-1 '*Mc Donald's*'.



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- [www.altavista.com/search](http://www.altavista.com/search)

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## APPENDIX-1

## • FRANCHISE GLOSSARY

## • COMMON FRANCHISE TERMS



# FRANCHISE DICTIONARY

## **Advertising Fee**

An annual fee paid by the franchisee to the franchisor for corporate advertising expenditures; usually less than three percent of the franchisee's annual sales and usually paid in addition to the royalty fee. Not all franchisors charge advertising fees.

## **Area Franchise (aka: Development Agreement, Master Franchise)**

A franchise granted to develop a defined geographical area. May include a strict performance schedule and franchise sales rights.

## **Business Format Franchising**

The franchisor licenses the franchisee to use product, service, and trademark. Also teaches the franchisee the entire business format, including marketing, selling, inventory, accounting, personnel procedures, etc. Furthermore, the franchisor provides support via training and communications to the franchisee for the duration of their business relationship. Restaurants, retail and many service businesses are business format franchisors.

## **Capital**

Capital is cash in checking and savings accounts, insurance policy cash values, non-IRA stocks and bonds, and loan receivables due within 30 days.

## **Company-owned Outlet**

Some franchisors establish company-owned stores or offices that, in appearance, are identical to the franchised outlets.

## **Copyright**

The exclusive right of a person to use, and to license others to use, an intellectual property such as a book, pamphlet, or other published material.

## **Conversion Franchise**

This is a franchise that permits existing businesses to join a national franchise system to use its recognized name and trademark and operating system.

## **Disclosure**

Revealing facts to others. In the sense used herein, these facts may be complimentary to the franchisor or may be uncomplimentary, such as disclosing a prior bankruptcy or litigation involving the franchisor or key persons as defendants.

## **Disclosure Document**

All franchisor companies are required by the Federal Trade Commission (FTC) to provide this document to prospective franchisees at the first personal meeting to discuss the sale of the franchise, and at least ten business days prior to the prospective franchisee signing a franchise agreement, or paying the franchisor money to buy the franchise. The document aids the prospective franchisee's evaluation of the franchisor company.

## **Distributorship**

A right granted by a manufacturer or wholesaler to sell a product to others. A distributorship is normally not a franchise. However, certain distributorship arrangements may qualify as a franchise, may be licensed or be adjudged a business opportunity requiring disclosure.

## **Federal Trade Commission**

The U.S. government agency which regulates franchising. Located in Washington, D.C.

**Franchise**

An agreement, whether written or oral, for consideration, by which a person permits the distribution of goods or services under his trademark, service mark or tradename, during which time the grantor retains control over others or renders significant assistance to others. (This definition is substantially that of the Federal Trade Commission. See the Final Interpretive Guides, Federal Register, Vol. 44, No 166, Friday, August 24, 1979, p. 49,966 et seq.) Counsel should also research definitions in controlled jurisdictions, applicable case law and formal and informal opinions rendered by State and Federal regulatory authorities.

**Franchisee**

A person or entity to whom the right to conduct a business is granted by the franchisor or licensor.

**Franchisor**

A person or entity issuing or granting a franchise or license.

**Franchise Fee**

A one-time fee paid by the franchisee to the franchisor to "buy into" the franchise. Generally, the fee reimburses the franchisor for the costs of initial training and support for new franchisees.

**Franchising**

Neither an industry nor a business, but a method of doing business within a given industry. At least two parties are involved in franchising: the franchisor and the franchisee. Technically, the contract binding the two parties is the franchise.

**Franchise Agreement**

Sets forth the expectations and requirements of the franchisor. Describes the franchisor's commitment to the franchisee. Includes information about territorial rights of the franchisee, location requirements, training schedule, fees, general obligations of the franchisee, general obligations of the franchisor, etc.

**Franchise Feasibility Studies**

Franchising can be a highly effective method of financing expansion through the acquisition of outside capital. The objective of a franchise feasibility study is to determine the degree to which a company, whether a well-established concern, a small operation of one or two units, or simply a concept that bears the characteristics of a successful franchisor, may be successful as a franchisor.

**Housemark**

A trademark used to identify the commercial operations of a company, and may also be the company name (as in Dupont). The name may be used to identify one or more products, and may be used in combination with other trademarks or trade names.

**Identify Items**

Those items (such as paper products, uniforms, point of sale materials or exterior signs) are usually required to be used in a franchisee's business. These items display the registered trademarks of the franchisor.

**Initial Investment**

Usually includes the franchise fee and the total investment amount including working capital required to commence operating a franchise.

**International Franchise Association (IFA)**

Trade association for franchisors. Based in Washington, D.C., the IFA requires its members to follow a rigid code of ethics.



## **Licensing (see Franchising)**

### **Marketing Plan**

A technique by which franchises are to be sold. Includes the number of sales anticipated within a series of time periods (first year, second year, etc.), to whom those sales are to be made (profile of the individual, area franchising, sub-franchising), and the anticipated geographical expansion of the franchise system.

### **Master Franchisee**

Describes an individual or company owning the exclusive rights to develop a particular territory for the franchising company.

### **National Alliance of Franchisees (NAF)**

A national coalition organized in 1977 to represent and protect the interests and rights of franchisees. National headquarters are in Washington, D.C.

### **Offer**

An oral or written proposal to sell a franchise to a prospective franchisee upon understood general terms and conditions. Note: Under state and federal regulations, the term "offer" is broader than the common law contract law definition.

### **Operating Manual**

Comprehensive guidelines advising a franchisee on how to operate the franchised business. It covers all aspects of the business, including general business procedures not necessarily peculiar to the franchised business. It may be separated into different manuals addressing such subjects as accounting, personnel, advertising, promotion and maintenance.

### **Person (by definition in franchise context)**

An individual, partnership or corporation.

### **Pro Forma**

A balance sheet, profit and loss or cash flow statement which estimates income and expense sources. Assets, liabilities and net worth are forecast on the balance sheet. Pro forma statements issued by the franchisor to the franchisee should be based on actual operating results of the franchisor's units or franchise establishments.

### **Protected Territory**

A designated area or geographic boundary granted to the franchisee by the terms of a franchise agreement. The franchisor covenants not to open another franchised or company owned business of a like or exact nature within the franchisees protected (assigned) territory.

### **Quality Control**

The method by which the franchisor enforces the rules of operation set forth in the operating manuals. Quality control involves Regional Coordinators visiting each franchisee.

### **Qualification Questionnaire**

A document prepared by the franchisor to be completed by the prospective franchisee, which provides initial information to the franchisor in order to assist him in determining whether or not the prospect is capable and motivated. Often a financial statement is included in the questionnaire format.

### **Regional Development Agreement**

a.k.a. Regional Franchisee, Regional Coordinator Franchisee; a franchise granted to develop or sell a person's



franchise rights to a third party in a defined geographical area. A portion of the franchise fee is normally paid in advance for a certain minimum number of franchise outlets which may be activated by the Regional Franchisee or sold at a disclosed fee to an individual franchise buyer. This agreement normally awards a share of the initial full franchise fee and a percentage of the royalty payment.

### **Registration**

A requirement in several states that specific information be submitted and approved by state regulatory authorities before franchises may be offered in that state. As compared to "disclosure" (see above), material contained in the registration is more extensive. For example: a bond, fingerprints and pictures of principal officers may be required in a certain jurisdiction. Note: the Federal Trade Commission has no provision for registration, thus the franchisor need only prepare an accurate and complete disclosure document conforming to the regulations.

### **Rules of Operation (see Operations Manual)**

Specific mandatory rules with which every franchisee and company outlet must comply. This document will change from time to time. By incorporation by reference in the franchise agreement, violation of the Rules of Operations allows the franchisor to cancel a franchise agreement.

### **Service Mark**

The specific statutory definition (15 U.S.C. Sec. 1127) states "...a mark used in the sale of advertising of services of one person and distinguishes them from the services of others." The word "trademark" is specifically associated with goods or products such as toothpaste or automobiles, whereas service marks relate to employment agencies, real estate chains and the like. They are both of equal stature and afforded the same protection under the law. (See Trademark)

### **Sherman Antitrust Act**

15 U.S.C., Sec. 107, as amended (1976), provides in general, that it is illegal to conspire by contract or otherwise, to restrain trade. Franchisee associations must be carefully monitored and franchise agreements drafted (except under certain case law exceptions), to avoid exclusive allocation of territories or fixing prices. As it affects franchising, the Sherman Act is applied to activities within a single state, whereas the Robinson-Patman Act can apply only to matters involved in two or more states (interstate commerce). The basic antitrust statutes have evolved since 1890 and each body of law has been enlarged and modified by the subsequent acts; some of which you will find in this directory. There are other anti-trust acts, notably the Federal Trade Commission Act, the Clayton Act and the state antitrust laws and "Little" FTC acts. In order to avoid antitrust problems, seek adequate legal counsel.

### **Slick**

A pre-prepared piece of advertising material usually composed by the franchisor for the franchisee for use in local print media. It is "camera ready", meaning that newspapers or other media can use it without significant additional cost to franchisees for composition and makeup.

### **Total Investment**

The amount of money estimated for complete set up of a franchisee's business, including the initial investment, the working capital, and subsequent additions to inventory and equipment deemed necessary for a fully operational and profitable enterprise.

### **Trademark**

The name associated with a product (see Service Mark). Prior to federal registration, the symbol "TM" or "SM" may be affixed near the word or words constituting the mark or symbol, to inform the public that it is intended that the name be protected.

### **Trade Secret**

(a.k.a. Proprietary product or service) Knowledge in the possession of the franchisor which is revealed to the franchisee by the franchise transaction. Trade secrets may take the form of construction or operating

procedures; a formula for the mixing of ingredients to prepare food, or the classical customer list. Appropriate legal provisions written into the franchise agreement, such as a covenant not to compete, are important in protecting these.

### **Turnkey**

The franchisor is responsible for fully developing a "turnkey" franchise until or after, the doors are open for business.

### **Tying**

Forcing a franchisee to purchase one product as a condition to the sale of another. Tying may be illegal if the products used in the franchise operation can be acquired from other sources at a more competitive price. The product must, however, be judged "equal to – or better than" the products specified by the franchisor in terms of quality.

### **Uniform Franchise Offering Circular (U.F.O.C., FOC)**

A form of disclosure document containing required information supplied by the franchisor to the franchisee. Initially promulgated by the Midwestern Securities Commissioners to provide a uniform method to disclosure for the benefit of franchisor and franchisee, its use is permitted in non-regulated states by FTC Rule 436.

### **Vertical and Horizontal Competition**

Applicable principally to price fixing or tying arrangements. Vertical connection deals with a buyer-seller relationship, as in franchisor-franchisee. (See Tying) Horizontal restraints of trade in franchising usually are concerned with potential price fixing arrangements among a group of franchisees (sometimes including company owned outlets) in a defined and homogeneous geographical area. Also in franchising, horizontal competitors are those offering a franchise or franchise product similar in price, whereas vertical competitors are similar in product or service but not in price. Price fixing is illegal at any level of an organization.

## **COMMON FRANCHISE TERMS**

**Advertising Levy.** Money paid by franchisees towards promotion activities. Usually it is paid as a percentage of turnover.

**Adjusted Net Profit.** The true profit of a business. Sometimes called 'Super profit'. The ANP is the tax profit or loss adjusted for non operational expenses used for legal tax deductions such as depreciation, interest on business loans and one off expenditure unlikely to recur, such as a major fitout. Only one owner's wage, plus his super, is allowed to be added back by convention. If a husband and wife team work the business, only one wage can be added back.

**Administration Levy.** This can also be called a 'service fee', or 'royalty'. However, unlike royalties that imply a passive income, the franchisor should provide a service for his fee that is usually paid monthly as a percentage of gross turnover.

**Arbitration.** By law, the franchise agreement must provide for a system of conciliation and arbitration.

**Assignment.** The sale of a franchise from one franchisee (assignor) to another (assignee). The franchisor normally must approve the assignee and often will charge an assignment fee to the assignor.

**Bank Loan.** A sum of money to assist the franchisee to buy any particular franchise. Often this is limited to only 2/3rds of the total price. Some franchisors that are well known can assist new franchisees to obtain pre-arranged bank finance from banks they deal with that are familiar with their systems.

**Business Format Franchise.** Also called Business System Franchise. This is where the franchisor provides the franchisee with a complete system for establishing and running the business.



**Buy Out Clause.** Not common, but allows the franchisee to buy himself out of the franchise yet continue to operate using his same location and the franchise system. This can be found where the franchisor can no longer provide a central administration or marketing service, or he just prefers to supply the consumables used by the franchisees.

**Company Owned Units.** Where the franchisor operates a franchise himself alongside the other franchisees. He must operate under similar costs and restrictions to others in the group.

**Disenfranchise.** Where a franchisor withdraws franchise rights from a franchisee mainly through frequent important breaches of the franchise agreement. A firm but fair franchisor is vital to allow the interests of the franchise group to be protected.

**Dispute Resolution.** See arbitration.

**Fixed Service Fee.** Where a fixed fee is charged weekly or monthly rather than a percentage. Sometimes a fixed fee is paid, plus a smaller percentage of turnover. As with most business strategies there are pros and cons to the fixed fee versus percentage of turnover approach. Fixed fees are often used where lots of small cash money is involved in the franchise turnover which the franchisee may not always declare.

**Franchise Advisory Council.** This may be an elected group from among the franchisees to assist franchisor with marketing and advertising decisions.

**Franchise Agreement.** The agreement between the franchisor and the franchisee that states obligations, benefits, overall conditions and costs attributable to each party. These agreements tend to be extremely long and detailed and need to be checked by someone experienced in dealing with such matters.

**Franchise Fee.** The initial payment by the franchisee in order to be accepted into the franchise. It is paid on settlement of the agreement. In 1998, the average initial fee was \$25,000.

**Franchisee.** An entity that buys a franchise from a franchisor.

**Franchisor.** The entity that sells the franchise to a franchisee. Normally, the business systems of the franchise have been proven by the franchisor by his running a pilot project beforehand.

**Franchise Council of Australia Ltd.** Established in 1982, the FCA consists of franchisors, franchisees and advisors who meet on a regular basis throughout Australia. The FCA provides publications and coordinates exhibitions and conventions.

**Goodwill.** Assessed on the value of established profitability of a business and the probability of that profitability continuing on.

**Intellectual Property Rights.** Trade marks, service marks, know-how and copyright.

**Lease.** Sometimes the franchisor takes out a head lease over the premises and sub leases this to the franchisee. The rental may be based on a turnover factor to cover service fees. Sometimes the franchisee holds the lease.

**Licensee.** This is also called a master licence or state licence and is where a big franchise operator may sell a licence to international or inter state franchisors who in turn sell the franchises to franchisees in their territory and oversee the efficient operation of the franchise system. Usually, if a master licence is in place, franchise agreements are a three way affair involving the head franchisor, the master licensee and the franchisee.

**Multi Level Marketing.** MLM is not franchising and involves tiered marketing practices normally sold via sub distributors direct to the public without use of a retail premises.

**Multi-Unit Franchise.** A franchise with one than a single unit. These are where a successful franchisee has established a franchise and put a manager in place and then taken on another franchise. This is common in the US, but not in Australia where many franchisors see the presence of the owner of the franchise as vital to its success and therefore tend to prohibit a franchisee owning more than one franchise.



**Multiple Franchisors.** Franchisors who offer multiple franchise concepts.

**Operations Manual.** Provided to the franchisee to give him detailed guidance about how to establish and operate his franchise. These manuals contain much of the intellectual rights of the franchisor.

**Party Plan Selling.** Similar to MLM and not included in franchising.

**Pilot Franchise.** A franchise established and run by the franchisor in order to test the viability of his system, service or product. It also helps him to develop his training systems and manuals.

**Plant and Equipment.** Needed to operate the franchise and bought at settlement. When a franchise is assigned, there may be different methods or a combination of methods used to value the P&E.

**Product.** For franchises that supply product, the agreement usually stipulates which standard range of products must be used and nominates a supplier. However, the franchisor needs to ensure he does not breach the Trade Practices Act that bans the fixing of a line of supply or prices. This now prevents many franchisor's from trying to take a 'margin' by adjusting the end price of the supplied goods or products.

**Pyramid Selling.** The selling of territorial rights through a tiered system where people involved in pyramid schemes make money solely from selling the tiered rights rather than a product or service. Pyramid selling is illegal in Australia and has nothing to do with franchising.

**Renewal.** Rights to a franchise are normally for a set period, say 5 years. After the expiry of the time renewal is necessary under various conditions. Franchises may not have the automatic right to renew, especially if they have continually breached the agreement or not proven themselves to be very successful. On a renewal, royalties, service fees, levies etc remain the same, but the costs of renewal may vary greatly. These cost will include legal fees.

**Return on Investment.** The RoI is a common way of assessing the worth of small businesses. It is the percentage of return a business owner will make in one year on his initial investment. The investment includes the value of the stock. The RoI is calculated by dividing the Adjusted Net Profit (ANP – see Adjusted Net Profit) by the total asking price including stock and multiplying the result by 100.

To obtain a suitable asking price, if you know the RoI, simply invert the equation. From the result take off the plant and stock value and this will leave the good will value, if there is any. The RoI will show up any business that are too high on stock or over capitalised.

Knowing which RoI percentages to apply and when and how to allow for businesses that naturally carry a lot of stock, such as bicycle shops and hardware stores, is a skill few persons outside professional business brokers have (this includes most accountants, who often are very inaccurate in their appraisals of businesses due applying incorrect RoIs because they are not in the buying and selling market every day and therefore out of touch with the buyer demand situation).

RoI works on a market demand system whereby various industries such as retail, contracting, manufacturing etc all have various RoI per centage factors attributed to them. The RoI factor attributed will also depend on the level of profitability of the business, not just the industry. The lower the RoI, the more demand there is for the business and usually, more secure the business is. For example, a newsagency with lotto, a highly regulated business may have a RoI of only 33%, whereas a high risk boutique may have an RoI of 130%. A manufacturer of pipes making \$60,000 pa ANP may need a return of 80% to be saleable, whereas a manufacturer of pipes making \$350,000 ANP may only need a RoI of 40% to be saleable.

**Royalties.** See Administration Levy.

**Service Fee.** See Administration Levy.

**Service Marks.** These are like trade marks, but apply to services rather than products and are a part of the intellectual property of the franchisor. They are afforded similar protection and it is vital, for the good of the franchisees, that the franchisor ensure he prevents unauthorised use of his intellectual property.

**Sub Franchisees.** These are granted within the territory of an existing franchise. This usually occurs where demand exceeds the original franchisee's ability to supply the demand. It is normal for the profit to go to the original franchisee and for the franchisor to allow the sub franchise, but to charge an upfront franchise fee and training fee.

**Term.** The term of the franchise. Most used to grant terms of up to 5 years. These days it is more common to grant terms from 10 to 30 years.

**Territory.** Most franchises stipulate an exclusive territory where a franchisee can operate without competition from his own group. A common franchise phone number is often structured so that calls are automatically diverted to the franchisee that holds the territory from where the call originated.

**Turn-Key Operation.** Where the franchise is completely established ready for opening day.

## APPENDIX-2

- Self Test-1

- **Selftest-2**



## **Self Test-1 Determine if you are suited to Franchise Ownership**

The purpose of this test is to give you a good read on your suitability to own a franchise. Be upbeat when answering, avoid being hypercritical and preventing yourself from ever purchasing a franchise. Just be honest with yourself. You will really know if franchising is right for you.

- 1) Why specifically do you want to own a franchise? Is it to get rich, or is it to get on easy street and not have to work hard or work long hours? Is it to be your own boss and control your own destiny? Is it because you just can't stand what you're doing now?
- 2) Are you money motivated? Do you have to make more money? Do you feel that you are at a dead end where you are now?
- 3) Do you fit in the corporate environment? Do you like working for someone? Have you ever been called a misfit, a maverick, or a malcontent?
- 4) Do you really enjoy working hard, even if there is no immediate reward?
- 5) How self reliant are you? Do you wait for others to take the initiative? Do you need the approval of others and considerable support before you make a decision, start a task, or move in a new direction?
- 6) Are you a risk taker? Are you willing to place your time, energy, and money into a venture that has the possibility of failing?
- 7) Do you take real pleasure in being the boss, or having the authority and responsibility for the success or failure of a new venture?
- 8) Are you a positive person?
- 9) Do you have good people skills? Can you interact with people effectively? Do you like people?
- 10) Can you stick to the franchisor's system, or do you have to do everything your way?
- 11) Do you like to teach? Do you enjoy training people in new tasks?
- 12) Can you handle multitasking? Can you cope with the multiple demands of operating a business?
- 13) Are you willing to accept the help of others?
- 14) Do you have the determination to get what you want and go for it 100 % ?

## **Selftest-2 Determine what type of franchise is best fit you**

The purpose of this test is to help you look at certain realities that may have a significant impact on your probability of success in franchising. It is only an aid. After considerable research and thought, you will know the best franchise for you.

- 1) What is your educational background? What is your work experience? What do you really know how to do well?
- 2) What do you absolutely love doing? What are your hobbies?
- 3) Do you really like people? Do you have good "people skills?"
- 4) Are you introverted or extroverted?
- 5) Are you the hands on or hands off type?
- 6) Are you willing to work long hours, six to seven days a week?
- 7) Are you a risk taker? Are you willing to bet on a new unproven concept or would you be more comfortable with a well-established, proven, franchise concept?
- 8) Do you like to sell?
- 9) Does the idea of really becoming part of a community appeal to you?
- 10) If a particular type of franchise looks attractive, can you see yourself spending your days for the next 5-10 years in that specific type of business?

## **GENERALLY ASKED QUESTIONS TO MC DONALD'S WITH ANSWERS**

**Q:** What business qualifications does McDonald's seek in its potential franchisees?

**A:** The following qualifications, among others, are essential to be considered for a McDonald's franchise:

-High personal integrity

-An entrepreneurial spirit and strong desire to succeed

-A proven ability to motivate and train people

-The ability to manage finances

-A willingness to personally devote full time and best efforts to the day-to-day operation of the restaurant as an on-premise owner-operator

-A willingness to complete a comprehensive training program and become proficient in all aspects of operating a McDonald's restaurant business

-Financial resources

**Q:** How much does a McDonald's franchise cost?

**A:** Typically, new restaurant costs range from 455,000 to 768,500 USD. The size of the restaurant facility, area of the country, pre-opening expenses, inventory, kitchen equipment, signage, and style of decor and landscaping will affect new restaurant costs. These costs are paid to suppliers. In addition, at the time of opening, an initial fee of 45,000 USD is paid to McDonald's Corporation for all new restaurants

**Q:** How much cash (or liquid assets) is required to acquire a franchise?

**A:** The initial cash investment is a minimum of \$175,000 for a conventional purchase or \$100,000 for a Business Facilities Lease .

**Q:** Will McDonald's finance the remaining balance of the cost of the franchise?

**A:** No. McDonald's does not provide any financing. The remaining cost may be financed through a bank

**Q:** May I obtain the funds to purchase a franchise from a relative, friend or associate?

**A:** No, because this would then involve you in a type of partnership. We do not franchise restaurants to partners or investors. An individual must personally meet the financial



qualifications and be willing to devote his or her full time and best efforts to the day-to-day operation of the restaurant. A franchisee must divest himself or herself of all other active business interests.

**Q:** Is there any way I can be considered if I do not have all the required financial resources?

**A:** In a limited number of cases, McDonald's grants a Business Facilities Lease (BFL) franchise to candidates who excel in all qualifications but are unable to meet the financial requirements of the conventional franchising program. An individual must have a minimum of 100,000USD of non-borrowed personal resources to be considered for a franchise under the BFL program.

**Q:** What is the availability of opportunities in my country?

**A:** The availability of franchises in specific geographic areas must be discussed with McDonald's franchising personnel in the specific country for which you have interest. However, as you can appreciate, McDonald's cannot predict which locations will be available when your training is complete. Therefore geographic flexibility is a characteristic we seek in candidates.

**Q:** Will McDonald's buy a piece of property that I own and then sell me the franchise for that location?

**A:** Our franchisee selection process does not play a part in our site selection. In other words, we develop a location because we think it will be successful and without regard to whom the franchisee may be. McDonald's does all of the site evaluation and selects the location. We acquire the property, improve the site and construct the building. The franchisee is responsible for equipping the facility with all necessary items of kitchen equipment, seating and decor, signs and landscaping, etc. As sites are developed, we offer them to candidates who have already completed training and are approved to become owner-operators. .

**Q:** How much money will I make?

**A:** Profitability varies depending upon a number of factors, including sales, location, occupancy and operating costs and the ability of the franchisee to manage and control the business. Questions related to profit and loss are discussed during a later stage of the selection process.