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## Development of Franchising in the Emerging Market of Croatia

Ilan Alon, Mirela Alpeza, Aleksandar Erceg

### Abstract

Franchising is a new sector in transitioning and emerging Croatia. Those companies involved in retailing, distribution, and wholesaling operations are now becoming aware of the benefits (and costs) of franchising as an organizational method and are considering its adaptation to the local context. However, 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 contribution is an assessment of the franchising model in the Croatian context.

**Key words:** International business environment, Franchise development, Transition and emerging market economies, Croatia.

### Franchising as a World-wide Phenomenon

Academic research into the field of franchising has been conducted for over 20 years, but it intensified in the 1990s, focusing on a global context. It has become an increasingly interesting business concept, with aspects and variables attracting attention from researchers in several specific fields: in entrepreneurship, since it represents a driving force in starting a business venture; in marketing, representing a main distribution channel in emerging economies; in strategic management, as an important form of organization; and in finance, through the capital investment structures of franchise businesses.

The increase in the academic community's interest in franchising's opportunities and challenges has coincided with an increased intensity of franchising's worldwide implementations over the last two decades, especially visible in the USA and Europe (Alon and McKee, 1999). International Franchise Association (IFA) research from 2004 shows that 45% of retail business in the 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 5,500 franchisors with over 266,000 franchise locations in Europe.

Although franchising as a business model undoubtedly shows exceptional potential and adaptability to different industries and business environments – even four decades after the first franchise appeared in the Croatian business environment – it has still not been fully developed as a business model. This paper explores the current condition of franchising in Croatia together with its development potential and identifies main obstacles to its broader

implementation and acceptance as a desirable business model for entrepreneurs looking to start or grow their businesses. We combine primary information from industry participants – bankers, lawyers, consultants, franchisors, and would-be franchisees – with statistics previously published to gain a better understanding of Croatian franchising in particular, and franchising in transitioning and emerging economies, more generally.

### **Defining the Concept of Franchising**

A “franchise” represents a business relationship where “. . . one firm (the franchisor) sells the right to market goods or services under its brand name and the use of its business practices to a second firm (the franchisee)” (Combs, Michael, and Castrogiovanni, 2004). Curan and Stansworth (1983) provide a narrower 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 franchisor.”

Kidwell, Nygaard, and Silkoset (2007) emphasize that the franchise concept is one of the key strategies for growing a business worldwide; however, the success of this strategy relies heavily on the relationship developed between franchisor and franchisee, i.e., on the franchisor's ability to prevent opportunistic behavior by the franchisee (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.* (2004) present two main distinctive characteristics of franchising in comparison to other organizational forms: 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).

Most research on franchising is based on agency theory and/or resource scarcity theory. Major assumptions and predictions of these theories are summarized in Table 1.

### **Advantages and Disadvantages of Franchising**

The franchise agreement governs the business relationship between two parties – franchisor and franchisee. As with any business relationship, it also implies certain advantages for both parties, when 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, and increased competitiveness. Spasić (1996) outlines the following advantages from the franchisor's standpoint: rapid expansion, benefit of using the local market expertise of the franchisee, and better managerial skills combined with greater drive and motivation of the franchisee (compared to an employed manager, e.g. an outlet manager). The most serious potential disadvantage is the franchisee's infringement of agreement provisions dealing with quality standards. Parivodić (2003) identifies potential loss of control over the franchise network as one of the main disadvantages from a franchisor's viewpoint, with other authors listing additional disadvantages: lesser profit, potential conflicts with franchisees, and the inability to influence the franchisee's recruitment policy.

**Table 1. Major Assumptions and Predictions on Franchising According to Resource Scarcity and Agency Theories**

	<b>Major assumptions</b>	<b>Major predictions</b>
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 re-purchasing 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

Franchisees, on the other hand, find starting their own businesses with a proven business idea and a well-known brand and trademark to be the major benefits of entering a franchisor's network. Other advantages include training, economies-of-scale advantages, fewer potential errors in business processes, product and quality standardization, and access to the franchisor's research programs knowledge base. Main disadvantages connected with franchise purchase are limited decision-making freedom, i.e., an increased dependency on an occasionally inflexible franchising system; the relative inequality of the parties as they negotiate the agreement; and the franchisee's obligation to pay all debts without regard to financial status.

However, despite all the potential disadvantages, franchising has become a broadly implemented business model: a healthy balance of mutual interests can be established between franchisor and franchisee where every franchisee's success contributes significantly to the development of the franchise network as a whole (Alon, 2005).

### **Economic and Entrepreneurial Environment to Franchising in Croatia**

Franchising development possibilities in Croatia are directly influenced by the general state of the economy. Economic indicators like GDP growth rate (as shown in 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 slow rate of national economic recovery from the consequences of war, privatization processes, and economic 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/e-ekonomski\\_indikatori.htm](http://www.hnb.hr/statistika/e-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/e-ekonomski\\_indikatori.htm](http://www.hnb.hr/statistika/e-ekonomski_indikatori.htm) May 20, 2007)

According to the Strategic Development Framework 2006-2013 (2006), key problems for Croatian economic development are:

1. Systems of government and culture generally inconsistent with Western forms of State involvement in private business, such as franchising.
2. Lack of an entrepreneurial climate.
3. Unfinished privatization and restructuring processes.

Low levels of entrepreneurial culture, combined with prolonged privatization and restructuring processes, have slowed investment processes by both domestic and foreign investors. Due to these continuing economic conditions, foreign investors (potential franchisors included) are still cautious when considering business expansion in Croatia, and those who do decide to enter this market have difficulty finding entrepreneurs interested in establishing business partnerships.

Figures for Croatia show an increase in entrepreneurial activity year after year measured by the TEA index published by GEM. The Global Entrepreneurship Monitor (GEM) is a joint research project with 42 participating countries set up to measure entrepreneurial activity in participating countries, identify factors of influence on entrepreneurial activity, and draft proposals for policy actions which can facilitate entrepreneurial activity levels in a member country. Entrepreneurial activity, measured by the TEA, represents the percentage of start-up entrepreneurs in the total of adult population sample (age 18 to 64).

Croatian entrepreneurship is characterized by a 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 trying to seize a perceived market opportunity (also measured by the 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, although opportunity outnumbered necessity in Croatia, the country still ranked bottom in the list of 42 countries participating in this research project (Singer *et al.*, 2007). "Necessity entrepreneurs" embark on their business ventures with minimal investment and are unlikely to become potential franchisees who need to be able to invest larger initial capital in their business (Table 4).

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

maturation rate 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

**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. 2007 p. 17

**Table 5. Entrepreneurial Capacity in the 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. 2007 p. 29

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 franchisors, and the GEM research project indicates the insufficient pool of companies with franchisor potential. Both start-up entrepreneurs and their "grown-up" counterparts conduct their respective businesses in an environment of intense competition and low level of innovation (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. 2007 p. 33

According to the "Global Corruption Report," an assessment of public perception of corruption among public servants and politicians conducted by Transparency International and published in 2007, Croatia ranked 69<sup>th</sup> out of 163 countries surveyed. Businessmen and analysts taking part in this assessment have given it an overall grade of 3.4 (on a scale where 10 represents total lack of corruption, and 0 represents a highly corrupt environment). This would indicate a high level of mistrust towards public institutions. One of the key characteristics of successful 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 levels of trust in Croatia do not represent a healthy basis for franchise partnership development.

## **The Legal Environment for Franchising in Croatia**

Over the last two years, the country has adopted numerous legal documents enabling it to join WTO and CEFTA and laid the foundation for starting negotiations to join the European Union. Nevertheless, there is currently no specific legal framework for franchising in Croatia.

The concept of "franchising" was first introduced to the Croatian legal system by the Trade Act of 2003. However, the activity is insufficiently controlled as no regulation specific to franchising was inserted. Instead, current civil, contractual, and commercial laws govern the franchising relationship. A provision in Article 21 of the Trade Act (Trade Act, Official Gazette, 2003) states that the "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 for selling certain types of products and/or services."

Since October 1st 2003, in accordance with the provisions of the Competition Protection Act, the Competition Protection Agency is responsible for evaluating every franchise agreement within thirty days of the signing of the agreement. At the same time, pursuant to Article 11 Section 4 of the Act, the Agency can initiate an agreement evaluation procedure if the effects of the respective agreement (individual or cumulative) with other similar agreements in a relevant market do not fulfill the conditions for exclusion. These changes in the Competition Protection Act are the result of a screening process and necessary adjustments of the Croatian legal system to harmonise with the European Union legal system. The European Union provides exemption for franchising in its competition law.

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

## **Current State of Franchising in Croatia**

Even though the franchise business model has been present 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. A franchise agreement enabled the franchisee based in Zagreb to operate in the whole of the former Yugoslavia and other Balkan countries. The Croatian Diners Club franchisee received two awards from the franchisor for exceptional business results achieved in the Eastern European market (Vidučić *et al.*, 2001).

The first significant discussions on advantages and disadvantages of the franchise business model in Croatia took place when McDonald's entered the market in the early 1990s. McDonald's established a company, McDonald's Hrvatska Ltd., and signed business agreements with key suppliers' strategic partners with some of them investing more heavily 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 franchising to other locations. McDonald's presentations in cities where the franchisor sought partners/franchisees generated great interest from potential franchisees with much discussion over the nature of the franchise agreement offered by McDonald's: i.e., to the

rights and obligations of both sides in a franchise relationship. A few years following McDonald's entry into the market, several other franchisors appeared in the Croatian market, the Hungarian bakery franchise Fornetti and the U.S. restaurant franchise Subway among the most recognizable.

According to an assessment by the Croatian Franchise Association (Kukec, 2006) there are currently about 120 franchises operating in Croatia (with 25 Croatian franchisors) (Table 7). The same source identifies over 900 franchise locations with approximately 16,000 employees. Franchising encompasses 20 different industries, and more than 20% of the total hospitality and trade industries are conducted by companies that use a franchise business model.

**Table 7. Comparison of the Number of Franchises in Croatia and Selected European Countries**

	<b>Total number of franchises</b>	<b>Number of domestic franchisors</b>
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 24<sup>th</sup>-25<sup>th</sup>*

### **Institutional Support for Franchising in Croatia**

The Croatian Franchise Association was established in 2002 to promote and advertise franchise licensing, to provide a forum for franchisors, and to establish policies and standards for franchise licensing in Croatia (Croatian Franchise Association, 2007). Even though the mission and objectives of this Association are of great significance for franchisors, especially taking into consideration the low level of awareness of basic franchising concepts among entrepreneurs, the Association (at the time of writing in January, 2008) has few members. Main activities of the Association have been to promote and advertise franchising opportunities in various media and the coordination of an international forum, The Franchise and Partnership Expo in Zagreb. Between 2003 and 2006, this event offered regular conferences with a number of domestic and international experts specializing in different aspects of franchising (for example, bank representatives, lawyers, university professors, and representatives of major franchisors) as guest speakers and participants.

However, the number of exhibitors at The Croatian Franchise Forum has declined over the last few years (in 2003 there were 35 exhibitors; in 2004 – 29 exhibitors; in 2005 – 15 exhibitors); the main cause for this is the size of the market (4.2 million people), which is seen as too small for large franchisors.

Another significant institution involved in franchise promotion is The Franchise Center, established as an arm of The Center for Entrepreneurship Osijek in 2003. The Center is focused on educating interested parties in the process of becoming franchisors and/or franchisees. The 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 materials used in this seminar have been harmonized with 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 late 2006, the 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 offered by The Franchise Center. In addition to educational programs, The Franchise Center's employees work as consultants and intermediaries in bringing together potential franchisors and franchisees.

In addition to these two institutions, 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. Promaturo provides its clients with consultancy services in establishing franchise networks of Croatian companies and advises all clients interested in becoming franchisees of an available franchise business.

### **Primary Information from Franchising Stakeholders**

Research entitled "Franchising development perspectives in Croatia" was conducted in September 2006 by The Franchise Center of Center for Entrepreneurship Osijek. During late 2006, "Entrepreneurial Croatia" – a USAID SME support project in Croatia – co-financed the visit of professor Ilan Alon, who worked together with The Franchise Center's representatives and held several workshops on franchising for:

- a) Lawyers interested in providing consultancy 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 – i.e., potential franchisors.

Each of the workshops offered a survey where all participants were asked to complete a questionnaire designed to analyze 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. The questionnaire used in the survey can be found in Appendix 1. 45 participants took part in the survey (15 lawyers, 15 bankers and 15 consultants).

The majority of survey participants agreed on two service-based industries with promising franchise-based growth potential: tourism and the 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 – linked with mistrust of foreign franchisors and their lack of interest in entering the Croatian market; and a general lack of knowledge on the advantages and opportunities of franchising as a new business model by all sides who could benefit from franchising development (bankers, entrepreneurs, support institutions, or consultants).

Main operational challenges influencing the development of franchising in Croatia identified by survey participants (bankers, lawyers and consultants) are shown in Figure 1.

Lack of awareness of franchising as a business model in the 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.

**Figure 1. Franchising Stakeholders' Perceptions**



**Table 8. Major Opportunities and Threats for Franchise Development in Croatia**

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

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

**Table 9. PEST Analysis of the Major Environmental Factors Influencing Franchise Development in Croatia**

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

Survey participants made positive forecasts on the development of franchising in Croatia with its accession to the European Union being identified as the development accelerator. The number of franchisors and franchisees is expected to 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 in and surrounding Zagreb, Split and Istria.

**Case Study: Eye Optics Lens**

Dubravka and Damir B. opened Eye Optics Lens – the first privately owned optical retail in Osijek in late 1980s. After some years, they started to grow their business into eyeglass manufacturing and soon became the fourth largest eye glass manufacturer in Croatia. Their business expanded to opticians' equipment distribution and servicing for a top-quality Japanese manufacturer and the exclusive dealership agreement for a broad geographical area. This expansion, optical equipment distribution and sales of eye glasses both retail and wholesale, helped them to establish business contacts with a number of optical retail businesses in Croatia. They have also received many inquiries from entrepreneurs interested in starting their own optical businesses. Dubravka and Damir have provided these entrepreneurs with optical equipment, free information and advice on running their

businesses, and have assisted them in establishing new business contacts. Now with 15 years of expertise in the optical industry and consultancy, they decided to systematize their knowledge and offer it to potential buyers using franchising as a business growth model.

After the final decision of creating their own franchise network was made, they faced numerous challenges in trying to bring their idea to life: the potential buyers' market wasn't sufficiently educated on the possibilities and advantages of franchising; there was a paucity of legal experts with experience in dealing with the franchise business concept; there was no legal framework established for this business model; and there were no financial products and services offered by the banking industry, which would facilitate the growth of the potential franchise market. After facing these challenges and realizing the current state of franchising in Croatia, Dubravka and Damir 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. They have decided to return to their core business instead. Franchising as a business growth model will have to wait for better times in their case.

## Conclusion

Franchising represents a business growth model with a broad array of implementation possibilities in developed and developing economies worldwide. Key advantages of this business model lie in quick growth and expansion possibilities, risk minimization and lower investments. Its success derives from establishing and managing a healthy balance of mutual interests between the franchisor and the franchisee.

Franchising has been present in some form in Croatia since the late 1970s, but the first real promotion of this business model brought McDonald's into the country in the 1990s. However, franchising growth has stagnated to a degree due to the general economic situation, a weak entrepreneurial climate, and the low level of innovation and competitiveness of Croatian companies. At the same time, there are only two franchise support institutions operating in the country – The 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 a legally unregulated area, insufficiently educated potential franchisees, and a dearth of adequate financing products and services for franchise purchase. Many potential franchisees, faced with these challenges, decide to give up their idea of growing their businesses via franchising (see, for example, the Lens Ltd. case), which leaves a total of between 25 and 30 Croatian franchisors operating currently in Croatia (based upon unofficial information provided by Croatian Franchise Association), a significantly smaller number when compared to some other transitional 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.

The environment for franchising is less than hospitable: low level of entrepreneurship (particularly opportunity-driven entrepreneurship), lack of franchising know-how, mistrust in society, corruption in public spheres, lack of franchising's legal framework, and small population, to mention a few. Offsetting the pessimism are two salient factors: (1) EU integration will lead to harmonization of rules and possible convergence in consumption

patterns promoting franchising, and (2) the tourism and hospitality industries, which need the international standards offered by franchising, are both organized and growing, providing an opportunity for franchising development. The authors believe that gradual implementation of franchising, through the development of local chains, conversion of existing businesses, and entry of foreigners, will ultimately give the stimulus for this sector's development and prosperity.

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## Appendix 1:

Questionnaire used for the Survey “**Franchising Development Perspectives in Croatia**”

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?

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