

**A NEW PARADIGM OF FRANCHISE DEFINITION:
FRANCHISING VS. LICENSING**

Asst. Prof. Dr. Mohd Amy Azhar Mohd Harif, C.A.(M) (corresponding author)

Faculty of Finance and Banking

University Utara Malaysia

06010 Sintok

Kedah Darul Aman

Malaysia

Fax : +(60) 4 9286437

Tel : +(60) 4 9286406

e-mail : amyazhar@uum.edu.my

ABSTARCT

INTRODUCTION

For this study, we will view definitions and types of franchising from two perspectives: the West and Malaysia.

Definition of Franchising in the West

Several definitions are used by practitioners and academics to define franchising - the definitions of franchising vary from one country to another (Justis 1995; Mendelsohn 1999; Mendelsohn & Bynoe 1995). Thus this research synthesises a comprehensive definition for the purpose of this research. Table 1 lists the elements of franchising definitions of six Western sources, and they will be discussed below.

Table 1
Elements of franchising definitions, in order of use

No.	Franchising elements	A	B	C	D	E	F	Total	This research definition
1	A grant of the right to use the brand name, system or distributorship	✓	✓	✓	✓	✓	✓	6	✓
2	Branding of the name (trademark, service mark, trade name)	✓	✓	✓	✓	-	-	4	✓
3	A system (procedure)	✓	✓	✓	-	-	-	3	✓
4	The contractual relationship between franchisor and franchisee	✓	✓	✓	-	-	-	3	✓
5	The franchisor obligation to franchisee	✓	✓	✓	-	-	-	3	✓
6	The payment of consideration from the franchisee to franchisor, either directly or indirectly	-	✓	-	✓	-	-	2	✓
7	The ownership of, and investment in, the franchised business by the franchisee	✓	-	-	-	-	-	1	✓
	Total	6	6	5	3	1	1		7

Legend:

A = *International Franchise Association* in Mendelsohn (1999)**

B = *British Franchise Association* in Mendelsohn (1999)**

C = *Franchising Code of Conduct* (1998)**

D = Justis & Judd (1998)*

E = Terry (1991)*

F = Norback & Norback (1982)*

Note: * = academic

** = franchising society or practitioner

Source: developed for this research

Selecting these six definitions was based on the background of the researcher or source, year of the research or source, and the elements in each definition. Firstly, the selected researchers are from a range of sources from academics, especially experts in the franchise area (columns D, E, and F in table 1) to a franchising society or franchising practitioner (columns A, B, and C in table 1). Secondly, although one definition is from the 1980s (column F in table 1), most are from the 1990s (columns A, B, C, D, and E in table 1). Finally, the selected literature provided a reasonably broad definition of franchising (table 1).

So, consider the definitions. Firstly, some definitions appear to provide a *narrow* or basic picture of franchising. An example of this type of definition is: franchising is a business opportunity by which the owner (producer or distributor) of a service or a trademark product grants exclusive rights to an individual for the local distribution and/or sale of the service or product and in return receives a payment or royalty and conformance to quality standards (column D in table 1) (based on Justis & Judd 1998).

Another somewhat narrow example is: franchising is a business that uses a license from the franchisor to operate the franchise business and to market and distribute goods, services, and technology (columns E and F in table 1) (based on Norback and Norback 1982; Terry 1991). Both definitions are narrow because they do not include elements such as branding of the name, the system, the ownership of investment, obligation of the franchisor to franchisee, payment to franchisor, and the contractual relationship between franchisor and franchisee (compare entries in the column of 'this research definition' in table 1).

In contrast, some other definitions are *comprehensive*. However, each of these misses an element that another does not. As the first example of these comprehensive definitions, franchising has been comprehensively defined by the Australian Franchising Code of Conduct as a franchisee's business with a franchisor's mark, that is, a brand name and the franchisee is required to conduct the business in accordance with a system specified by the franchisor (column C in table 1) (Franchising Code of Conduct 1998). This comprehensive definition of franchising also includes a contractual arrangement and the franchisor provides ongoing marketing, business and/or technical assistance during the life of the franchise agreement. Nevertheless, this definition does not include the element of payment by franchisee to franchisor and the ownership investment in a franchised business by the franchisee (compare entries in the column of 'this research definition' in table 1).

Consider a *more comprehensive* definition used by the British Franchise Association (BFA) (column B in table 1). BFA has defined franchising as a license granted by one person (the franchisor) to another (franchisee) which permits or requires the franchisee to carry on during the period of the franchise a particular business under or using a specified name belonging to or associated with the franchisor, and the franchisor is entitled to exercise continuing control during the period of the franchise over the manner in which the franchisee carries on the business which is the subject of the franchise (Mendelsohn 1999). This BFA definition of franchising also includes the obligation of the franchisor to provide the franchisee with assistance in carrying the

franchise business and requires the franchisee periodically during the period of the franchise, to pay to the franchisor a sum of money in consideration for the franchise; and for goods or services provided by the franchisor to the franchisee. However, this definition does not include the element of ownership investment in the franchised business by the franchisee (compare entries in the column of 'this research definition' in table 1).

Finally, another even *more comprehensive* definition of franchising has been used by the International Franchise Association (IFA) (column A in table 1). IFA has defined franchising as a contractual relationship between the franchisor and the franchisee in which the franchisor offers or is obliged to maintain a continuing interest in the business of the franchisee in such areas as know-how and training, in which the franchisee operates under a common trade name, format and/or procedure owned or controlled by the franchisor, and in which the franchisee has or will make a substantial capital investment in the business from his/her own resources (Mendelsohn 1999). However, although this definition focuses on some applications, it does not include the important element in franchising of the payment of fees (compare entries in the column of 'this research definition' with what in table 1).

From the above definitions, we can synthesise a new definition of franchising, that is, definitions of franchising cover *seven elements* that are listed in table 1 and discussed above include:

1. a grant of the right to use the brand name and system or distributorship;
2. branding of the name (trademark, service mark, and trade name);
3. a system (procedure);
4. the contractual relationship between franchisor and franchisee;
5. the franchisor obligation to franchisee;
6. the payment of consideration from the franchisee to franchisor, either directly or indirectly, in the form of franchise fees and other fess; and
7. the ownership of, and investment in, the franchised business by the franchisee.

In summary, this comprehensive list of seven elements on Western franchising will be the basis of developing a new definition applied to Malaysian franchising.

Definition of Franchising in Malaysia

Apart from those Western definitions, definitions of franchising in Malaysia should be considered. There is a legal definition of franchising in Malaysia (Malaysian Franchise Act 1998). However, it is helpful to also examine other definitions of franchising adopted by authors in Malaysia. There are three definitions used by the practitioners to define the franchising that has been used in Malaysia including the definition by the Malaysia Franchise Act 1998, as shown in table 2. These definitions will be compared with the seven Western-based elements of franchising (from table 1). The three definitions were selected based on factors such as background of the definition, and contents of the franchising definition. The selected definitions are from a range of backgrounds such as franchise consultant (C in table 2), franchise legal consultant (B in table 2), and Malaysian Franchise Act 1998 (A in table 2).

Table 2
Comparison of the Malaysian franchising definitions with the seven elements of franchising (from table 1)

No	Seven elements of franchising (from table 1)	A	B	C	Total	This research definition
1	A grant of the right to use the brand name, system or distributorship	✓	✓	✓	3	✓
2	Branding of the name (trademark, service mark, trade name)	✓	✓	✓	3	✓
3	A system (procedure)	✓	✓	✓	3	✓
4	The contractual relationship between franchisor and franchisee	✓	-	-	1	✓
5	The franchisor obligation to franchisee	✓	-	-	1	✓
6	The payment of consideration from the franchisee to franchisor, either directly or indirectly	✓	-	✓	2	✓
7	The ownership of, and investment in, the franchised business by the franchisee	✓	-	-	1	✓
8	Flagship outlet operated by franchisor (prototype outlet)	-	-	-	0	✓
	Total	7	3	4		8

Legend:

A = *Malaysian Franchise Act* (1998)

B = Sam (1999)

C = Bustaman (1995)

Source: developed for this research

Firstly, consider a *narrow* definition of franchising in Malaysia. Franchising has been defined as the business operation that involves more than the mere granting of a right or license (Sam 1999), that is, the grant of right to use a marketing plan or a system controlled by or associated with the franchisor, and the grant of a right to use a trade mark, trade name service mark, trade secret, confidential information, and other intellectual property rights of the franchisor (column B in table 2). Although such a grant is subject to continuing control by the franchisor over the significant aspects of the business, the franchisee depends in some degree on continuing supplies of goods and/or services from the franchisor (column B table 2). However, this definition does not include elements in franchising such as payment matters, franchisor obligations, contractual agreements, and ownership investments in the franchised businesses (compare entries in the column of 'this research definition' with those in table 2).

In contrast, a more *comprehensive* definition of franchising is a method of distributing goods or services and typically it involves the franchisor, who for a fee or fees, licenses to one or more franchisees a complete business structure or format, which

may include the business name, trade-marks, appearance, trade secrets, patents, copyright, designs, procedures, technique, business manuals, finance and accounting system, and employee uniforms (column C in table 2) (Bustaman 1995). This definition only includes four elements but does not include elements such as contractual agreements, franchisor obligations, and ownership investments in franchised businesses (compare entries in the column of 'this research definition' in table 2).

In turn, the *broadest* definition of franchising in Malaysia is provided by the Malaysian Franchise Act 1998 (column A in table 2). The Act has adopted the classic definition of franchise to mean a contract or an agreement, either expressed or implied, whether oral or written in which (based of Malaysian Franchise Act 1998):

- the franchisee is given the right to operate a business according to the franchise system during the stipulated term;
- the franchisee is also given the right to use a mark, or a trade secret, or any confidential information or intellectual property, owned by the franchisor or relating to the franchisor;
- the franchisor has the right to administer continuous control over the franchisee's business;
- the franchisor has a duty to provide assistance to the franchisee to operate his /her business;
- the franchisee 'may' be required to pay a fee 'or other form of consideration'; and
- the franchisee operates the business separately from the franchisor.

The additional element to be added in the franchising definition is flagship outlet. The franchisor needs to build and operate the flagship outlet to be shown as a proven outlet for the particular franchise system.

Thus this definition of franchising comprise eight elements is the most comprehensive and covers all the seven Western elements of franchising in table 1 (entries in the column of 'this research definition' in table 2).

TYPES OF FRANCHISING

Having defined franchising, now consider the various types of franchising systems that fit this definition to select the type that is most relevant to this study. Five main types of franchising arrangements are practiced in Malaysia: product manufacturing licensing franchising, dealership/distributorship franchise, trademark/brand name license, promoter and business format franchising (Awalan 1999c; Franchise and Vendor Development Division 1999). In contrast, there are only three main types of franchise business in Australia (Franchising Task Force 1991; Frazer & McCosker 1999; Swanson 1976; Terry 1991), four types of franchising in United Kingdom (Mendelsohn 1999) and two types of franchising in United States of America (Justis & Judd 1998) (although the categories are not always similar). We will discuss all the five main type of franchise business that are practiced in Malaysia, and relate them to Australia, United Kingdom and United States of America. Table 3 compares main type franchising from various countries, and will be discussed next.

The first type of franchising is *product manufacturing licensing* (row 1 in table 3). This type of franchising is practiced in Malaysia, Australia, United Kingdom and United States of America (row 1 in table 3). The franchisee is a granted license to produce goods/items according to the formula, recipe or design prescribed by franchisor and market goods/items using the franchisor's marketing system (Awalan 1999c; Franchise and Vendor Development Division 1999). Similar to this type of franchise business is *process or manufacturing licensing franchising*, in which franchisor supplies raw materials and/or specialised knowledge to a franchisee that manufactures and wholesale distributes the finish product (Awalan 1999c; Panettiere 1995). It is common in the soft drink and alcohol industries where independent bottlers produce the product under a franchising arrangement, for example Coca-cola is also produced Malaysia (Noraini 1998).

Table 3
The comparison of main type of franchising

No	Type of franchising	Malaysia (A)	Australia (B)	United Kingdom (C)	United States of America (D)	Total	This research
1	Product or process manufacturing licensing	✓	✓	✓	✓ ←	3	✓
2	Dealership/distributorship	✓	✓	✓	✓ ← co	3	✓
3	Trademark/brand name license	✓	-	✓	-	2	✓
4	Promoter	✓	-	-	-	1	✓
5	Business format franchising	✓	✓	✓	✓	4	✓
	Total	5	3	4	2		5

Legend:

A = Franchise and Vendor Development Division (1999), Malaysia

B = Franchising Task Force (1995), Australia

C = Mendelsohn (1999), United Kingdom

D = Justis & Judd (1998), United States of America

co = combination of product manufacturing licensing and dealership/distributorship (product franchising) as product and trade name franchising

Source: developed for this research

Some researches from United States of America have combined the two types of franchising-product or process manufacturing franchising (row 1 in table 3) and dealership/distributorship franchising (row 2 in table 3) as *product and trade name franchising*. (Justis 1995; Justis and Judd 1998) In this type of franchising the business has an independent sales relationship, one company product line and include industries such as automobile and truck dealers, gasoline service stations and soft drink manufacturer (Justis 1995).

The second type of franchising, *dealership/distributorship*, is characterised by product distribution arrangements between various parties (row 2 in table 3). This type of

franchising is practiced in Malaysia, Australia and United Kingdom (row 2 in table 3). The franchisee will market franchisor's product exclusively according to the prescribed rules and methods. (Franchise and Vendor Development Division 1999; Mendelsohn 1999) The franchisee is given the monopoly right to market the product in a specified geographical area. Under this dealership/distributorship franchising, a distributor acts as an outlet (wholesale or retail) for the products within a specified territory. In contrast to the product type above (product and processes or manufacturing franchising), in this type of franchising, the franchisor and not the franchisee, manufactures the product. Franchising is commonly used in motor vehicle dealership and petrol retailing (Shannon 1982). Examples of this type of franchising in Malaysia are Petronas Service Station, Shell Service Station and Caltex Service Station (Noraini 1998).

Thirdly, *trademark/brand name* of franchise business occurs the franchisee is granted a license to sell franchisor's goods and paid commission for sales (row 3 in table 3). The franchisee has the responsibility to ensure a reasonable sales audit (Franchise and Vendor Development Division 1999). This type of franchising is only practiced in Malaysia and United Kingdom. In contrast with the dealership/distributorship type, the franchisee in this type of franchising will get a commission and could sell other products. Examples of this type of franchising in Malaysia are Walt Disney and Piere Cardin (Noraini 1998). The next type of franchising is *promoter* in which franchisee will sell good/items that are purchased from franchisor (row 4 in table 3). This type of franchising is practiced only in Malaysia. The franchisee will use the company name, as do the rest of the other franchisees. (Franchise and Vendor Development Division 1999) The franchisor will provide capital, raw, material, management and marketing expertise to the franchisee. In contrast with trademark/brand name franchising, the franchisor in this type of franchising provides all the facilities to the franchisee – this does not happen in trademark/brand name franchising. Examples of this type of promoter franchising in Malaysia are Pernas Edar, Avon and Arastu (Noraini 1998).

All these four types of franchising were established some years ago (Awalan 1999c). However, this research is delimited to the fifth type, *businesses format* franchising (row 5 in table 3). Business format franchising is characterised by the cloning of a unique business system using standard procedures (Stanworth and Smith 1991; Frazer 1997). The franchisor normally will provide expertise such initial training, and start-up assistance in operation, financial planning, accounting standard, ongoing support, and monitor the quality and adherence to the system (Awalan 1999; Franchise and Vendor Development Division 1999; Frazer 1997). The franchisor will market a unique business system under a trade name and the franchisee will adopt the standardised procedures to run their own businesses (Frazer 1997). Business format franchising occurs over a range of industries such as the traditional fast food and retail outlets through to real estate, business services, education and construction industries (Franchising Task Force 1991).

In addition, the business format franchise involves the exploitation of not only the goods identified by a trademark or services identified by a service mark, but also the preparation of the 'blueprint' of a successful way of carrying on a business in all its aspects (Padden 1995). The blueprint must have been carefully prepared to minimize

the risks inherent in opening any new business (Mendelsohn 1999). Most business format retail franchises are slim margin, cash based operations and are often staffed by family members for both cost saving and shrinkage control (Kaufman & Stanworth 1995).

This type of franchise business is the most rapidly growing sector and is responsible for the most franchising in Australia, United Kingdom and United States of America (Frazer 2000; McCosker 1995; Mendelsohn 1999). Moreover, business format franchising is the most popular and the most comprehensive franchise business in Malaysia (Awalan 1999c). Through the Franchise Development Program (FDP), a large number of businesses have formed using this business format franchising (Malaysian Franchise Directory 1999). Examples of franchises in Malaysia are Nelson, Mc Donald, KFC, Marry Brown, and Hotel Seri Malaysia (Noraini 1998)

In brief, all these five types of franchising fall within the seven elements of franchising (refer table 2). But, in particular, business format franchising matches the seven elements of franchising defined in the Malaysia Franchise Act 1998 (column A in table 2), and will be used for this study.

CONCLUSION

In brief, the definition of franchising in the Malaysian Franchise Act 1998 should be used as a new paradigm of franchise definition and the five type of franchising should be fit within this new paradigm.

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