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NATURE OF COMPETITION IN THE PHILIPPINE FRANCHISED RETAIL SECTOR

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Abstract: Franchising as a form of entry strategy in the retail industry has gained popularity in the last two decades. With the increasing levels of competition in the market, to venture into business as a greenfield form of business is found to be too risky making franchising a more acceptable alternative entry strategy. Using a survey conducted of retail establishments, the study tries to look into the different demographic, pricing, and marketing factors that account for the nature of competition of franching in the retail sector. Comparisons are conducted across such variables as the organizational set-up, asset size, operation, rivalry, barriers to entry and price adjustments. These variables are likewise compared with the same set of variables for non-franchised firms. A profile is established of franchised and non-franchised firms on the basis these categories according to different retail subsectors. Cross-tabulation of data further provide insights into other similarlly unobserved relationships that can enhance understading of how a franchise system works. The results are inconclusive but point to greater returns for non-franchised establishments but acceptable low returns for franchised firms given comfortable levels of risk. This study can become take-off points for policy research on the economics of franchising.

1. Introduction

For the past decades franchising as a low-risk level of business entry has gained popularity among budding enterpreneurs who lack the capability to get a greenfield business off the ground. This alternative form of entry has also become more acceptable to individuals who are making attempts at switching from being employed to venturing on their own. The benefits of buying into a franchise include greater chances of achieving profitability within a shorter time frame, less costly operations on a long term basis, available assistance from the franchisor regarding advise on site selection and store interior design, marketing and advertising, staff and management training, supply chain access and quality research and development. These benefits seem to outweigh the upfront costs of buying into a franchise, restrained manuverability for introducing creative business ideas, slow adaptability and response to local market opportunities, agency problems between contractual parties and increasing competition among other franchise establishments and independently run retail outlets. A retail establishment's response to market competition is a key factor to its survival regardless of the nature of business entry that it takes. Examples abound of home-grown businesses that have weathered unforgiving competitive conditions of the market because of their immediate response and adaptability to market sentiments and needs, capitalizing on networks in the communities they serve, a focus on being people-oriented (whether staff, management or customer) without sacrificing system development, build-up of expertise within a specific market niche. Dant and Gundlach (1998) have found that organizational as well as interorganizational literature have identified environmental uncertainty and its dimensions to be strategically critical variables in understanding approaches to decision-making, operations and business processes, citing theorists positing environmental threats as the raison d' etre for organizational adaptation. The economic impacts of franchising include output and job creation, increase in tax base, modernization, current accounts adjustments and SME development. (Alon, 2004)

The establishment of a retail outlet warrants consideration of a format that, from an enterpreneurial perspective, best meets the owner's objectives within the context of value creation, profit enhancement, outlet growth and expansion. From a marketing perspective, there is the realization that the consuming public, from any demographic categorization, has, more than ever, greater access to efficient and effective forms of low-cost communication, varied sources of real time information and more advanced computing technology. The effect is increased exposure to a variety of choices and addressing their needs with increased knowledge of supply alternatives. Their experiences with consuming products and utilizing services find expression through an increasing number of networking sites whose influence can spell success or failure for a well-known retail outlet.

Despite the recognized economic impact of franchising in the growth of small businesses in the Philippines, hardly any research has been conducted on the aspects dealing with the nature of competition facing franchised retailers and how this compare with non-franchised retail outlets in the same retail category. Using a survey conducted of selected franchised and non-franchised retail establishments, this study examines the different demographic, pricing and market strategic factors responsible for the nature of competition in the retail sector. This study likewise attempts to determine if there are inherent differences in the manner franchised and non-franchised retail establishments respond to competition and if being in a franchise provides added protection against increasing competitive threats of the market from the benefits normally identified by their form of business entry. Similarly, this paper likewise extends a formar study conducted previously on the dynamics of franchising as a hybrid organizational form (Delfino, 2004)

2. Methodology

Cross-tabulations of data gathered from a survey conducted with various retail establishments, as part of a course requirement in microeconomics classes, generates a wealth of information from which some conclusions can be drawn about product, market, pricing, perceptions and response to competition when taken as a whole. Convenient sampling selection was conducted and is basically purposive in data collection to reveal as much information on the various aspects regarding the nature of competition in the retail sector. The survey questionnaire was constructed without being intrusive of the manner by which information is gathered that would make the respondent less parsimonous in his/her sharing of vital information. Data gathering, therefore, of specific information regarding financial performance was avoided and instead only percentages on average rates of returns, sales/revenue growth, price difference between retailers and wholesalers were solicited. The study then is purely descriptive with qualitative data presented in a manner that would make evident similarities and differences among franchise and non-franchise establishments.

Since the sample selection was purposive or essentially selecting from a limited number of retail establishments, the choices of firms to be interviewed was highly dependent on contacts by the interviewees. As such, more non-franchised firms ended up in the sample as this particular categorization (i.e. whether franchised or not) considering the focus of the overall study is in the area of microeconomics called monopolistic competition, though franchising is a very good example for the applications of the theories developed under this particular market structure. Out of the overall sample generated, seventeen (17) retail outlets are franchised. The same number of retail outlets in the sample were likewise selected to represent non-franchised retailers. For each category, thirteen (13) of the establishments are in the food and beverage sector, one (1) in clothes distribution, two (2) in general mechandising or convenience stores and one (1) in transportation parts and equipment merchandising. A total of thrity-four (34) outlets were selected to be included in the sample for this study.

3. Results and Discussion

An examination of firm demographics shows the general preference for locating in malls or along main roads for franchised firms as compared to the spread in the preference by non-franchised outlets, the

latter choosing to locate, as well, along secondary roads. Site selection is found to be a critical factor that would enable a franchise applicant to get approval to become a franchisee. This explains why the malls are generallly more preferred, on the overall, followed by sites along main roads as foot traffic in these areas are higher. The average age of the outlets is higher for non-franchised firms at 8.75 years compared to 7.33 years for franchised outlets. Size of establishments is relatively spread for franchised firms but the greatest number are small sized firms. Non-franchised establishments, on the other hand, are largely microfirms. Majority of non-franchised establishments in the sample are proprietorship in legal
structure whereas franchised retailers were corporate entities. This can be explained by the large initial capitalization required of franchise buyers when setting up the retail outlet, necessitating shared investments. For outlets that are proprietized, there is basically no difference in the average age of the owners at 40.7 years and 39 years for franchised and non-franchised outlets, respectively.

Since a majority of franchised outlets are essentially corporate entities, it is not surprising that a larger number of franchised outlets are day-to-day managed by hired managers (70.6 percent). Non-franchised outlets are generally managed by the owner/proprietor (60 percent). Table 1 above provides details on firm demographics.

Table 1: Firm Demographics

Firm Demographics	**Franchised Firms**	**Non-Franchised Firms**
General Location		
Inside Mall	8	7
Along Main Road	8	6
Along Secondary Road	1	4
Average Age of Outlet	7.33 years	8.75 years
Size of Establishment		
Micro	6	13
Small	7	1
Medium	2	3
Large	1	0
Number of Employees		
Micro	9	11
Small	6	3
Medium	0	2
Large	2	1
Type of Retail Establishment		
Food/Beverage	13	13
Clothes	1	1
General Mechandise	2	2
Transportation/Equipment	1	1
Type of Legal Entity		
Proprietorship	7	10
Corporation	10	7
Average Age of Owner	40.7 years	39 years
Management (day-to-day)		
Owner	29.4%	60%
Hired Manager	70.6%	40%

With increasing levels of competition in the local market, retailers, whether franchised or not, survive the market using basically the same pricing strategies. Both categories utilize cost of item plus a fixed percent profit margin to price their products, although for franchised retailers the pricing is almost always dictated by the franchisor. The greater flexibility that non-franchised outlets enjoy gets manifested in their capability to follow the same pricing structure of their competitors whenever this becomes the basis for their product/outlet selection especially for very price-sensitive consumers like students and retirees.

Price adjustments for both categories are done by way of increases in costs of operations and whenever an updated version of the product is introduced in the market. In terms, however, of income classification of their main clients, franchised outlets cater more to middle and low income clients whereas non-franchised firms in this sample cater generally to middle and high income clients. This may be accounted for by the latter's greater capability to product differentiate while responding to the needs of the immediate market at a much faster rate. Product quality has garnered the highest rank in retailers' perceptions of why consumers prefer their products over others. In terms of sales pick-up during a week, the highest ranks are Saturdays and Sundays for franchised retailers, followed by Mondays whereas sales pick up on a Friday for non-franchised retailers followed by Saturday. This is explained by the mall crowd that swells during weekends and office employees taking their lunch and shopping in malls, as well, at the beginning of the week. The highest sales are realized in the month of December for both franchised and non-franchised establishments followed by June and May for these categories, respectively. Noticeably, though, for all days of the week and for nearly all months of the year, most franchised retailers encounter higher sales than non-franchised retailers. The rankings of competitive factors are found in the table below.

Table 2: Rankings of Competitive Factors of Franchised and Non-Franchised Retailers

Competitive Factors	Franchised Retailers	Non-Franchised Retailers
Pricing Strategy		
1st rank	Cost of items plus a fixed percent profit	Cost of items plus a fixed percent profit
2nd rank	Promotional pricing/discounts around	Based on what competitors charge for the same item
Price Adjustment		
1st rank	Whenever there is increase in retail and other related costs	Whenever there is increase in retail and other related costs
2nd rank	If an updated version of the product is introduced, adjustments done on older products	If an updated version of the product is introduced, adjustments done on older products
Main Market		
1st rank	Adults	Adults
2nd rank	Teens	Teens
General Income Category of Consumers		
1st rank	Middle Income	Middle Income
2nd rank	Low Income	High Income
Sales Peak during the Week		
1st rank	Saturday & Sunday	Friday
2nd rank	Monday	Saturday
Sales Peak – month of Year		
1st rank	December	December
2nd rank	June	May

Greater cut-throat competition is experienced by non-franchised retailers (71.4 percent) as compared to franchised retailers (62.5 percent). Both respond by way of differentiating their products or service, but added to this is that franchised retailers enjoy the benefit of aggressive advertising/promotion strategy by the franchise whereas non-franchised establishments rely on speedy and efficent service, especially after sales service. For franchised outlets, stocking well on fast moving items in the store helps them survive competitive pressures once the franchise has determined the appropriate pricing structure. Non-franchised establishments, on the other hand, conduct regular promotion and the bundling of products. Table 3 itemizes details on response to competition, barriers to entry and return rates.

There is no difference in their response regarding perceived barriers to entry as nearly 55 percent of those surveyed responded in the negative. For those who claimed the existence of barriers to entry, the factor that ranked first is large initital capital follwed by extensive product/service knowledge of the owners/incorporators and the staff. For non-franchised establishments, equally second in rank is the large inventory of products. Sharing the second rank for non-franchised firms is the lack of available space within the same area and the ability to negotiate for much lower prices from the manufacturer/wholesaler. The recovery of initial investments, on the overall, is only slightly shorter for franchised firms at 2.9 years in and 3.05 years for non-franchised firms when excluding outliers in the results. Average returns are generaly higher for non-franchised firms at 16 to 20 percent compared to franchised firms at only 5 to 10 percent, average sales revenue growth is spread for non-franchised firms while franchised establishments enjoy a low 5 to 10 percent growth. The difference between the retailer's and wholesaler's price is below 5 percent for franchised firms and 5 to 10 percent for non-franchised firms. This is consistent with the nature of supply chain relationship between the franchisor and franchisee whereby discounts in supplies are passed on to the retailer.

Table 3: Response to Competition, Barriers to Entry and Return Rates

	Franchised Retailers	Non-Franchised Retailers
Experienced cutthroat competition?		
Yes	62.5%	71.4%
No	37.5%	28.6%
Outlet response to competition		
1st rank	Differentiate product being sold and adopt a more aggressive advertising/promo strategy	Differentiate product being sold and speedy and efficient service
2nd rank	Stocking up well on fast moving items	Regular sales promo and bundling
Perceived barrier to entry?		
Yes	43.75%	46.15%
No	56.25%	53.85%
Sources of barriers to entry		
1st rank	Large capitalization	Large capitalization
2nd rank	Extensive product/service knowledge and large inventory	Extensive product/service knowledge, lack of available space, ability to negotiate lower
Return Rates		
Ave. Rate of Return	5 to 10%	5 to 10%, 16 to 20%
Ave. Sales Rev. Growth	5 to 10%	Highly spread
Diff bet retail & wholesale price	Below 5%	5 to 10%

The issue regarding control has been a topic of research in franchising. Controls assure the entire franchise of uniformity in quality and delivery of service and, since most contracts would stipulate such arrangements, nearly 94 percent of franchised establishments utilized nearly all of the softwares indicated on the survey, particularly with reference to sales monitoring, payment system, inventory stocking, logistics, cost control and electronic retailing. Their presence on the web is oftentimes mentioned in the literature for increase visibility. Only 66 percent of non-franchised establishments used software programs in their businesses, mostly for sales and cost controls.

Since franchised firms cannot do much by way of altering the product, their strength, from the perspective of consumer preference, is on friendly service and attractive prices. Whereas, product quality ranked first among non-franchised firms, followed by attractive prices and friendly service. Greater flexibility in the alteration of products and services give non-franchised firms an advantage in terms of niching and responding immediately to the needs of the market. Speedy response to market needs enables non-franchised firms to grasp a foothold over the market, especially where the firm can establish increased personal relationship and a network with its immediate market.

4. Conclusions

Distinct advantages differ for franchised and non-franchised establishments in the various categories of pricing strategy and adjustment, competitive response, perceived barriers to entry and return rates. But they tend to be similar in others like markets, peaks in week and month sales. As a popular form of market entry, franchised firms have not exhibited advantages over non-franchised firms in return rates, the latter seemingly being better off. Returns for franchised firms are relatively low but is almost always assured. For most enterpreneurs that choose this mode of entry find such returns highly acceptable considering comfortable risk levels.

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