FRANCHISE AGREEMENTS IN THE INDUSTRIAL SECTOR

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DECLARATION

I, HUGH DUDLEY KROG, do hereby declare that the Research Report entitled "Franchise Agreements in the Industrial Sector" is my own, unaided work except where otherwise acknowledged.

I further declare that this research report, or any part of it has not been submitted in the past, or is being, or is to be submitted for a degree in any university other than the University of the Witwatersrand.

The information used in the Research Report has not been obtained by me while being employed bv, or working under the aegis of any person or organization other than the University of the Witwatersrand.

HDKrog

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HUGH DUDLEY KROG

2nd Day of December, 1985.

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ABSTRACT

The purpose of this Research Report is to evaluate franchise agreements operating in the building and construction industry, in an attempt to provide a guideline for the form that such agreements should take in the future.

The report is essentially exploratory, with the research conducted being investigative and evaluative.

The first two chapters discuss the parameters of the report and analyse the theoretical composition of a commercial franchise agreement. This constitutes the bench mark against which agreements in the industrial sector are judged.

The investigative research was conducted in two parts. Firstly the franchise agreements were discussed at a personal level with the franchisors. Secondly the subjective part of the research was conducted by means of a questionnaire to franchisees in the industrial sector on a national basis.

The research indicates firstly that the agreements operating in this sector can be truly regarded as franchise agreements in spite of there being certain points of difference. Secondly it illustrates the differences between the kind of provisions the franchisees are currently forced to operate under, and those which they would, if given the choice, prefer to operate under.

Contentions issues identified in the agreements studied include:

- the lack of use of the franchisors name and logo by the franchisee,
- the lack of importance of location to the franchisee,
- the emphasis on the control motive by the franchisor,
- the provision for capital investments in place of up front fees,
- the requirements for proof of competence before granting a franchise, and
- the inability to use standard pricing in industrial franchises.

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CHAPTER ONE

SCOPE AND METHODOLOGY

1.1 The Role of Franchising in Marketing

Although franchising and its many aspects are discussed in detail in this report, a succinct definition is required to open, and perhaps the best is provided by Lowry who states that franchising

> "Is the right or privilege of one party to market another party's goods or services in a defined area."[1]

Within the context of this and similar definitions, franchising has been stated by Vaughn[2], to be the place variable in the marketing mix. As such it forms one of the controllable marketing variables that a firm (company) uses to blend with the other variables in order to achieve its objective in the target market(s)[3]. The use of this variable, i.e. the moving of a company into different market channels, particularly if these channels are in a growth phase, can offer the company a means of building up patronage with improved service.

It has been noted by many people that franchising as a concept has been in a growth phase for the past several years. While it may now have reached a degree of maturity in the U.S.A., Britain and Europe, it certainly has not been exploited to its full potential in many countries including South Africa. Before proceeding it is important to note some of the reasons for the surge of interest in franchising in general.

- Media costs, inflation and advertising clutter have raised the price of establishing a brand name.
- Shortening product life cycles in many categories have made marketing investments riskier.

- Consumers, beseiged by brand name overload, are looking for ways to simplify their decision-making process across categories.[4]
- The quest for standardisation.[5]

1.2 Objectives of the Research report

Franchising as a concept has been utilised from its inception in consumer markets. After having become established, it has however been applied more and more, in pure and not so pure form, to industrial markets. In this report the emphasis is on scrutinizing the construction industry specifically and analysing how franchising and the terms and conditions of a franchise contract in whatever form, may be applicable. With this background the report sets out to achieve the following specific objectives viz:

- To document the existing forms of franchise agreement (in whatever form) which are currently in operation in the industrialised and systems building markets.
- To enumerate the practical requirements of all parties to such agreements.
- To evaluate the degree of congruency between the way such agreements are operating and the "requirements" of the parties .
- To evaluate the degree of congruency between the standard type commercial franchise agreement and the "required" type for the construction industry.
- To set guidelines for the form which an industrial type franchise for the construction industry should take, in order to be agreeable to all parties, and to be "marketable" by a potential or existing franchisor in the industry.

1.3 Importance of the Research Report

1.3.1 Context of the report

It is important to note that the industry with which this report is concerned is the construction industry. This is an industry in which certain elements are of importance.

- The industry is extremely succeptable to fluctuations in the economy and as such is cyclical by nature.
- In spite of the current recessionary times there is an acute backlog, especially in the housing sector which has to be catered for.
- Traditional methods of construction, it is now accepted , are unlikely ever to be able to wipe out this backlog.[6]
- New methods such as system building and industrialised component manufacture, require equally progressive and new forms of marketing in order to succeed.[7]
- The industry is governed by statutory regulations in terms of what may and may not be built and how and where. Any agreement therefore has to be specifically in terms of such regulations.
- All new and innovative building methods are subject to testing and approval of both the products and the systems (or methods of erection) by officially recognised bodies such as the C.S.I.R.

1.3.2 National Building Regulations

The new National Building Regulations[8] which supercede the old Standard Building Regulations came into effect on September 1, 1985. Besides any of its other differences or improvements, the new document has a particular significance to this report. That is that the industrialised and innovative methods of construction which lend themselves specifically to franchise type operations are now deemed to be acceptable, in terms of the statute, for general use. The implication is that the way is now open for a large scale exploitation of such product/market segments without the official hinderance and harrasment which has stiffled their development so far. The need to have a franchise type agreement which is practical, marketable and implementable is therefore upon us.

1.3.3 The Agrèment Board

The Agrèment Board of the C.S.I.R, is a body which evaluates innovative methods of construction in the building industry. Should a new method or system be granted acceptance in terms of the test procedures set down, it will be awarded a certificate. This certificate has two important aspects in terms of the report. These are:

- The certificate qualifies the method or system (including the products used) as being necessarily suitable for use in terms of the National Building Regulations, and

- The certificate is only valid so long as the methods set out in it are adhered to, and then only by people licensed and registered as such with the Board by the licensor/franchisor.

1.3.4 IBASA (Industrialised Building Association of S.A.)

This organisation was formed in recognition of the specific requirements of industrialised building products and methods. Its objectives are inter alia:

- To provide advanced planning of the Industrialised Building Program in consulatation with client bodies.
- The development and acceptance of tendering procedures and conditions of contract recognising the particular needs of the industrialised building process.
- To rationalise the provision and installation of services

  There are currently some thirty (30) member companies with approximately 3 000 employees. This illustrates the magnitude which industrialised and systems building methods have already achieved.

1.4 Scope and limitations of the report

1.4.1 Scope

As stated the report is concerned with the construction industry. The title of "Franchising in the Industrial Sector" has two implications vis a vis the scope of the report. Firstly the building and construction industry is specifically industrial in nature when compared to the commercial sector which is generally envisaged as the domain of the technique. Secondly the building and construction industry itself is in many ways undergoing a process of rapid industrialisation, a phase through which all other types of industry have probably passed.

In this context the scope of the work is fairly narrowly defined to include large mother companies (the franchisors) and contractors (i.e., small entrepreneurial franchisees) engaged in new and novel materials and methods of construction. Large companies who are franchisees to other large companies in respect of a certain activity are not included as they are not considered entrepreneurial in the context of the report. Also cases where only a single franchisee exists (often owned by the franchisor itself) have not been considered. The intent of narrowing the scope to this extent is

- That there are relatively few such companies so that any results will be representitive in context;
- All these parties are having to find ways of marketing the new systems, and in doing so are right now at the forefront of all development in the novel utilisation of marketing variables. Also they have the use of historic data regarding successes and failures; and
- The methods being used are pioneering in a sense and new avenues and benefits discovered can have a direct and meaningful impact throughout the industrial sector in its broadest terms in the immediate future.

The report then covers manufacturers, contractors, and interestingly control bodies, instituted to monitor and evaluate any techniques used in the use of new mthods of operation.

1.4.2 Limitations

Because of the newness of the industry as such and the fact that legal consent has only recently been given, the number of operations open to be studied is relatively small. The study has therefore been limited to the four sectors of the "industrialised" building market where franchising systems are currently in operation viz, insulation products, timber frame construction, roofing, and componentized construction.

Each of these sectors is governed by one large corporation who is in the franchisor role and numerous franchises per agreement.

A further limitation lies in the relatively short periods for which agreements have been in operation. There has as a result of this restriction been little reappraisal by the participants of the systems in use. We are therefore dealing in the raw state of the technique. This in fact could be viewed as an advantage as it allows one to test the basic principles. The sampling itself was devided into two sectors. Firstly in terms of the franchisors, all known companies operating a franchise within the building sector were approached and their inputs were factual and situational. Secondly in terms of the contractors or franchisees, the study was limited to the opinions of individuals representing a cross section of all sectors. These people were from right across the country wherever they were practically reachable. It must be emphasied that because of the exploratory and judgemental nature of the sampling it was not possible to apply strict quantitative measures in determining the accuracy of the selection.

1.4.3 Previous Research

Although a lot has been said in recent times relating to the state of the industry, no studies have been conducted soliciting the opinions of franchisees on the terms and conditions under which they work. For this reason the study is of interest to IBASA, the Agrèment Board, and existing and potential licensees and licensors.

1.5 Framework of the Report

The report has been approached as a logical four stage process.

1.5.1 The General Theory of Franchising

The first stage is purely theoretical in terms of the report. It sets out the basic precepts of franchising as it is commonly known, reviews the traditional areas of application and degree of success in each area, lists and reviews the factors which have become the blueprints, cornerstones or essentials of franchise agreements, reviews the historical and traditional ways in which franchising has been applied to the industrial sector, and assesses the effectiveness of franchising in attaining the marketing objectives set.

1.5.2 The Research Program

In stage two the design and methodology of the physical research are set out.

The findings of the research are then set out covering the actual franchising contracts currently in use in the defined market, as well as the findings on what factors are theoretically required by the franchisees.

The differences between the actual and desired states are then examined and certain conclusions reached regarding the state of franchising in this market sector.

1.5.3 Comparison of the standard franchise to what is required for the construction industry

Critical issues which are the essence of a standard franchise contract are then compared with the issues which have been identified in the industry. Comparisons are made on areas of agreement, and disagreement and specific conflicts in unsettled or grey areas are analysed.

1.5.4 Conclusions and Recommendations

The final stage is the setting of a guideline for industrial franchising based on the conclusions reached in the first three stages. Areas of further study are suggested and a synopses of the state of the art in franchising in the building and construction industry is presented.

1. Lowry, J.R. Retail Management; (Chicago, 1983), P. 105.

2. Vaughn, C.L. Franchising; 2nd ed. (Toronto, 1979), P. 39.

3. Kotler, P. Principles of Marketing; (New Jersey, c. 1980), P. 88.

4. Quelch, J.A. "How to Build a Product Licencing Program." Harvard Business Review, May - June, 1985. No. 3, PP. 186 - 193.

5. James, D.L. et. al. Retailing Today; 2nd ed. (New York, 1981), P. 455.

6. Thomson, D.H. "Keynote Address". Paper presented at, "Innovation in Building - the way Ahead," congress, C.S.I.R., Pretoria, 1985.

7. Klopper, P.A. "The Backlog won't wait for Traditional Methods," Housing, June 1985, PP. 12 - 13.

8. National Building Regulations and Building Standards Act No. 103 of 1977. (Durban, 1985).

CHAPTER TWO

THE GENERAL THEORY OF FRANCHISING

2.1 Basic Precepts - Why franchise?

The question "why franchise?", would seem easily answered by quoting the often used American statistics referred to by Mendelsohn which suggest a 90 per cent failure for non-franchised new business over a five year period, compared with 10 per cent in the case of franchised new businesses in the same period.[1] More recent local interpretations of these figures tend to confirm their magnitude.[2]

Withoug pre-empting the discussion under 2.3, regarding the essential considerations of a franchise, there are two major features which place a franchisee opening for business in a very different position to a non-franchisee. The first relates to pre-opening training guidance and preparation for the prospective operation as well as the existance of an organisation to provide the necessary and on-going training and guidance. The second is the general involvement of the franchisee as the owner of the business.

To give an insight into why franchising still operates as a form of marketing or distribution in which the franchisor (or indeed licensor or agency grantor), grants the right or franchise to an individual or firm to do business in a prescribed fashion it is useful to quote Henderson as cited by Vaughn:

> "The term 'franchising' did not become prevalent in England until more recent centuries. Franchises were usually granted by royalty, or by legislative bodies. Franchising in the eighteenth and nineteenth centuries usually involved the acceptancr of certain specifc obligations on the part of a grantee, in return for certain specific privileges, usually of a long term nature, and frequently involving some monopolistic

advantages."[3] and on a slightly more pragmatic though synical level, Thomson states:

> "As was true with the beginning of automobile franchising, the answer to why the franchise form has been perpetuated seems to have been primarily economic. A financially independant franchisee can be forced to absorb part of the costs of over production or styling errors made by the manufacturer. These costs would have to be borne by the manufacturer in a system of manufacturer-owned outlets. Franchised dealers absorb the first impact of any price fluctuations at the retailing level, as the manufacturer's price fluctuates much less frequently and less strangely than do retail prices. The problem of used car trade-ins and resale introduces further financial uncertainties that are born by the franchisee rather than by the manufacturer. There are additional state taxes and fees to be paid where a nationwide manufacturer-owned retail system is involved. Also branch managers are not felt to have the same degree of motivation to succeed as the independant franchised dealer, who has both his income and his business investment to loose in case of business failure. Finally, franchised dealers are felt to have a stronger attachment to and report with the local community than would salaried employees of a manufacturer."[4]

While it is true that all of the historically recalled good and bad points outlined above still exist either together or separately in some current franchise arrangements, the emphasis on the "why franchise", question in current times, has been toward the marketing goals achievable via the technique in its various forms.

Currently franchising is really used as a means of accelerating the pace of market development and also of funding research. It has been said by Quelch,[5] that there are almost as many objectives for licencing as there are licencing agreements, but in spite of this the following list is an attempt at summerizing some of the most important.

- The launching of a national brand

  Specially, for example in respect of smaller manufacturers aiming to add to their profit margins.

- The quick penetration of new markets

  A typical example is the cross licencing type agreements used by pharmaceutical concerns who have specific geographic strengths but have developed products with a far wider appeal.

- The sharing of investment risks

  Particularly relevant to markets having short life cycles, unpredictable demand patterns and undergoing industry fragmentation, such as the fashion or toy industries.

- The adding of name awareness

  Life style advertising by cigarette or liquor manufacturers and even the marketing of clothes, etc. bearing the same brand names.

- The maxisation of profitability of existing lines

  Franchising cartoon characters etc. to gain further attention in declining markets.

- The revival of mature brands

  The franchising or licencing of lines which no longer demand adequate attention, because of reduced returns, to smaller manufacturers or outlets who will pursue their success with a new degree of enthusiasm.

- The control of subsidiaries policies

  Standardisation of product policy and presentation.

- The achievement of standardisation

  Satisfying the need or expectation for an offering to be similar in nature and quality in all outlets of the same name as well as from one purchase to the next.

2.2 Traditional areas of applications

As already stated, almost anything can in fact be franchised. Currently there are many types of transactions entered into, all of which are described as "franchises", but each having a different application and certain common and non-common characteristics.

Fortunately there appears to be general consensus regarding the basic types of franchise operations in existance. At this point it is useful to set out the catagories regarded as standard. Also at this point it is of interest to note the American catagorization of the construction industry as complying with a type 4 agreement as set out below. This is the "total business concept" or "business format" type franchise which includes things well known in South Africa such as fast food chains and hotels, and is therefore easily related to when comparing the research with the theoretical "essential considerations" as set out in 2.3.

The following are the generic sub-groupings of franchises. Their points of difference are essentially based on legal problems, the franchisor/franchisee relationships, and other self evident distinctions.

2.2.1 Type 1: Manufacturer/Retailer systems

This category includes some of the oldest franchise operations. Arrangements are very similar to the popularised type 4 system of business format franchise with the major point of difference perhaps being the aspect of non-exclusivity in some cases. Typically car and truck dealerships and petrol service stations would fall into type 1 franchising.

2.2.2 Type 2: Manufacturer/Wholesaler systems

Typically there are very few but large scale operations in this category. Best known are the soft drink bottling operations such as Coca Cola and other, e.g. beer bottling operations.

2.2.3 Type 3: Wholesaler/Retailer systems

The only clear distinction between this and the manufacturer/retailer system described in 2.2.1, is the difference in the franchisor's status: Rapid growth of this type of operation was in the 1930's and typical existing businesses include motor spare dealers, chemist chains, and perhaps supermarket groups such as SPAR.

2.2.4 Type 4: Trademark/Trade name licensor-retailers (Business format)

This category encompases the popularly identified franchises such as Kentucky Fried Chicken.

Typically the system involves the exploitation of not only identifiable goods but also the preparation of a "business format" or "blueprint" for a successful way of carrying on a business in all its aspects.

What is really being sold is a sub-system of a retail operation and a trade name with consumer recognition and attractiveness. The systems concept is specially important and the franchisor is in a way a management consulting firm possessing a trade name/product to sell.

While there are an inordinately large number of franchises in this category, some of the best known include Holiday Inns, Juicy Lucy, Hertz/Budget, etc. car rentals, and Pronto Print.

In order to give a final broad insight into the spectrum of franchise operations, the following is a listing of the major category headings to be found in the "Franchise Opportunities Handbook"[6] of the U.S. Department of Commerce:

- Automotive Products/Services
- Auto/trailer rentals
- Beauty Salons/Supplies
- Business Aids/Services
- Childrens stores/furniture/products
- Camp grounds
- Construction/Remodeling - materials/services
- Cosmetics/Toiletries
- Dental Centres
- Drug Stores
- Educational products/services
- Employment Services
- Equipment rentals
- Foods - doughnuts
- Foods - grocery/speciality/stores
- Foods - ice cream/yogurt/candy/popcorn/beverages
- Foods - pancake/waffle/pretzel
- Foods - restaurant/drive-ins/carry-outs
- General merchandising Stores
- Health aids/services
- Hearing aids
- Home furnishings/furniture retail/repair/services
- Insurance
- Laundries, Dry Cleaning - Services

- Lawn and Garden Supplies/Services
- Motels/Hotels
- Optical Products/Services
- Paint and Decorating Supplies
- Pet shops
- Printing
- Real Estate
- Recreation/Entertainment/Travel - Services/Supplies
- Retailing - not elsewhere classified
- Security systems
- Swimming pools
- Tools, hardware
- Vending
- Water conditioning
- Miscellaneous wholesale/service businesses

2.3 Essential considerations of a franchise agreement

In order to understand what the essential considerations of a franchise agreement are, it is necessary to go right back to the definitions and work up from there. From the accepted definitions one is able to set down the basic features of a franchise and extract from these features the essential considerations. In looking at the essential considerations of a franchise agreement, legal and technical areas have been excluded, e.g. the obligation to take out insurance cover in certain instances. This allows an extraction of the areas of principle of the contract and enables the comparison to these principles across different operational sectors. Having done this, it is also important to look at when exactly a franchise is not a franchise and then to set out the areas covered in a standard franchise contract.

- Lawn and Garden Supplies/Services
- Motels/Hotels
- Optical Products/Services
- Paint and Decorating Supplies
- Pet shops
- Printing
- Real Estate
- Recreation/Entertainment/Travel - Services/Supplies
- Retailing - not elsewhere classified
- Security systems
- Swimming pools
- Tools, hardware
- Vending
- Water conditioning
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2.3.1 Definitions

For the purpose of this exercise the official definitions only are used and the fringe areas of franchising are not considered. Probably the longest standing definition is the one that appears in the by-laws of the International Franchise Association, which is the trade association of American franchisors, and goes as follows:

> "A franchise operation is 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; wherein 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 his business from his own resources."[7]

A second important definition which serves to reinforce many of the American points, is that of the British Franchise Association, which defines a franchise as follows:

> "A contractual licence granted by one person (the franchisor) to another (franchisee) which
>
> a) 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
>
> b) entitles the franchisor 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; and
>
> c) obliges the franchisor to provide the franchisee with assistance in carrying on the business which is the subject of the franchise (in relation to the organisation of the franchisee's business, the training of staff, merchandising management or otherwise); and

d) requiries the franchisee periodically during the period of the franchise to pay to the franchisors sums of money in consideration for the franchise or for goods or services provided by the franchisor to the franchisee; and

e) which is not a transaction between a holding company and a subsidiary (as defined in section 154 of the companies act 1948) or between subsidiaries of the same holding company or between an individual and a company controlled by him."[8]

In order to gain a South African perspective the following is the way Mr Deon Abrahamse, General Manager of International Franchising SA (Pty) Ltd, is quoted as defining a franchise:[9]

> "A franchise is a business arrangement on which knowledge, expertise and often a trade mark or trade name are licensed to an operator. The 'franchisor' is the seller of the franchise and the 'franchisee' the buyer.
>
> The franchise can involve a product, where the franchisee acts as a wholesaler or retailer; a system where the franchisor permits the franchisee to use a particular method of doing business as in fast food outlets: or a manufacturing arrangement where the franchisor provides an essential ingredient or know-how."

2.3.2 Basic Features

Excluding things of a legal or technical nature, the above definitions all contain certain basic features. These features are common to most other definitions of franchise and it is true to say that all definitions contain some or all of these features.

The features which give form to the franchise contract are the following:

- There must be a contract containing all the terms agreed upon.

- The franchisor must initiate and train the franchisee in all aspects of the business prior to the opening of the business and assist in the opening.
- After the business is opened the franchisor must maintain a continuing interest in providing the franchisee with support in all aspects of the operation of the business.
- The franchisee is permitted under the control of the franchisor to operate under a trade name, format, and/or procedure, and with the benefit of goodwill owned by the franchisor.
- The franchisee must make a substantial capital investment from his own resources.
- The franchisee must own his business.
- The franchisee will pay the franchisor for the rights which he acquires in one way or another and for the continuing services with which he will be provided.
- The franchisee will be given some territory in which to operate.

2.3.3 <u>When is a franchise not a franchise</u>

While accepting the points set out under 2.3.2, Siegal suggests that it is important to be aware that some business opportunities look like franchises but aren't.[10]

Among the examples which are defined as definately not franchises are:

- Businesses where an identifyable national product is sold outright but there is no rolyalty demanded and no territorial integrity granted. The sellers only commitment is to re-supply.

- Businesses where a distributor grants exclusive selling rights within a territory. While authorised dealership is given there is no provision of help or guidance or the exercise of control by the parent company.
- The third type of operation which is not a franchise is the Pyramid Scheme. Here dealerships are sold to people who in turn sell more dealerships down the line. These schemes are common in South Africa in products such as cometics, clothing and kitchen and household items and are mostly sold to and through gullable housewives.

2.3.4 The franchise contract

A franchise contract is a legal document which has to take into account a number of different considerations relating to the standing of all parties to the contract, and while catering for the basic features outlined earlier, it must also answer all the "what if" questions likely to arise as a result of the agreement. As has been shown not all franchise arrangements are alike or of equal magnitude. It is therefore necessary according to Vaughn when producing a contract for a specific operation, that the legal taylor must of course cut his contractual cloth to conform to the contours of his client.[11] In short if the franchise agreement is drafted so that the parties know what they are doing when they agree, like what they are doing when they perform, and fear what they may suffer if they sin, the resulting contractual agreement should be workable and relatively non-litigous.

It has been suggested by Mendelsohn that the essential considerations may be set out under nine separate headings.[12]

Each separate heading really relates to an area or principle. While it is accepted that the nine areas or principles discussed below are general they are followed by a set of possible contractual provisions embodying these principles. The contractual provisions set out are not exhaustive, and the objective of listing them is to propose and not to dispose of illustrative issues relevant to a standard commercial franchise within the definitions already set out. This will then serve as the bench mark against which the industrial sector agreements analysed in Chapter 3 will be judged as complying or not complying.

Consideration 1

The franchise is an agreement between the franchisor and the franchisee essentially. There are however two other parties directly affected by this agreement viz. the other franchisees in the system and the consumer. In order to cater for these other parties it is necessary that restrictive provisions be introduced for their protection. In the case of the other franchisees what is at stake is the maintenance of the franchisee's reputation and status. If a franchisee operates in a manner inconsistant with the standards associated with the franchise he can damage the business prospects of the other franchisees.

As regards the consumer, he is concerned with the fact that he will be able to obtain a consistant standard of product or service from a particular "branded" business.

Consideration 2

The franchisor in the standard business format franchise is contributing his format or blueprint for the operation. This may comprise trade secrets, methods of operations, use of trade marks and names etc., and the franchisor is concerned that provision is made enforcing the franchisee:

a) to use these methods, trade marks and the like and

b) to ensure the preservation of any secrecy regarding the methods used.

Consideration 3

In order to achieve the goal, it is inherent in discharging the four way obligations set out in Consideration 1, that consideration is given to the way in which the necessary standards are imposed on the franchisee and what provisions should be made for the enforcement of those standards.

Consideration 4

Provision must also be made for the maintenance of the appeal of the business and its attractiveness to the consumer with the passing of time. This may mean periodic or ongoing contributions to a capital fund from which the franchisee can draw for the purpose of upgrading and may be contributed to by one or both parties. There must also be provision for the enforcement of such upgrading.

Consideration 5

The method by which the franchisor obtains his income and the obligation for initial and ongoing payments for whatever purpose by the franchise are a separate consideration category.

Consideration 6

Consideration has to be given to the circumstances under which the franchise agreement can be terminated. The position of the parties has to be addressed responsibly and the consequences of termination under differing circumstances have to be set out.

Consideration 7

Consideration must be had for the circumstances under which assignment may or may not take place. The difficulty here arises from the fact that there is in most franchises the requirement for the franchisee to be trained in specific areas of application. The franchisee cannot be allowed to assign his franchise when disposing of his business and safegaurds have to built in to ensure that if an assignment is allowed the new franchisee will undergo the necessary training, provide the same standards of product or service, etc., as if there had been no change of franchisee.

Consideration 8

Consideration also has to be given to things such as what happens to the franchisees business in the case of death. This obviously varies according to whether the business is a proprietorship, Limited Co., Partnership, closed corporation or whatever. The whole question of change of beneficial ownership has to be addressed in a clear fashion for the peace of mind of both parties.

Consideration 9

Consideration lastly has to be given to the franchisees point of view. It is important that all the aforementioned considerations be fair to both parties and that nothing be left to chance, trust or to implication.

The following contract provisions contain all the elements contemplated under the nine considerations set out. The format of these provisions follows that given by Von Cise as cited by Vaughn.[13] As this set of provisions has gained broad accpetance, it is thought to be applicable. Also the provisions are devided chronologically into four main sectors, viz.

- general provisions
- starting up provisions
- operating provisions, and
- termination provisions

which allows convenient analysis of the competing markets within this study.

The actual contents contemplated under each of the provisions are expanded in the questionnaire included as Appendix A.

a) General Provisions:
   - Description of the parties
   - Nature of the franchise
   - Territory of the franchise
   - Protection from competition
   - Representations by the franchisor
   - Representations by the franchisee

b) Starting up Provisions
   - Deposit of fees
   - Land and buildings
   - Equipment and facilities
   - Training of applicant
   - Transmission of standards
   - Opening for business

c) Operating Provisions:

- Assistance in purchasing
- Guidance in bookkeeping
- Management and Promotions
- Recommendations on Sales
- Performance by franchisee
- Reports and Royalties
- Insurance and taxes
- Confidentiality of disclosures

d) Termination Provisions:

- Renewal of terms
- Transfer of rights
- Terminations for cause
- Terminations without cause
- Obligations on termination
- Resolution of disputes
- Relationship of parties
- Miscellaneous other provisions.

2.4 Benefits and shortfalls of franchising as a technique

Throughout this study it has been evident that franchising in the industrial sector is to date largely by the franchisor for the franchisor. The factors of market expansion as well as control of installation, erection or manufacture are well documented. There are however other factors from both the franchisors as well as the franchisees point of view which bear mentioning.

2.4.1 Advantages and disadvantages to the franchisor

Vaughn[14] has suggested that when one considers the advantages and disadvantages of franchising to the prospective franchisor, it is necessary to review several things before arriving at conclusions; these are:

- the current stage in the life cycle of the company considering franchising;
- the alternatives open to the company;
- the type and extent of franchising possible; and
- the type and size of the product that will be the nucleas of the franchise.

Aside from these theoretical considerations there are several practical advantages which include:

- Centralised organisation and control of outlets without the high capital risk and management of small companies problems.
- The ability to expand using the minimum amount of risk capital.
- The ability to expand into areas not within the scope of the organisation.
- The aid of keen and motivated outlet managers who are keen to maximise profits.
- The assurance of wider distribution and secured outlets.
- The maintenance of standrads of control in erection/installation.

There are of course certain drawbacks to the franchisor as well. These include:

- Ensuring the maintenance of standards of quality and services, and supervising the same.
- Having to manage people who do not work for you but for themselves.
- The maintenance of trust between the franchisor and franchisee.
- The fact that you as franchisor may be grooming your own competitors.

2.4.2 Advantages and disadvantages to the franchisee

Inevitably where there is a profit to be made there is also a price to be paid. Without elaborating in too much detail at this point, some of the advantages and disadvantages facing the franchisees can be gleaned by reviewing the discussions in Chapter Three on the questions posed to the licensees.

Among the advantages listed by Mendelsohn[15] are the following:

- Training given by the franchisor often can overcome a lack of skill or specialised knowledge.
- The franchisee owns his own business and reaps whatever he puts into it.
- There is always the name and reputation of the mother company and its popularity to be considered, as well as the national advertising thereof.
- There is often the benefit of bulk purchasing and credit facilities which would otherwise not be achieved.
- The franchisors knowledge experience and expertise are always available.

- There is a proven reduction in business risk for franchised operations.
- The franchisee has the backing of the franchisor in any third party disputes or other problems which may arise in the course of business.
- The franchisee has the benefit of use of the franchisors name, trademarks, trade secrets, development expenditure, etc.
- The franchisor indulges in continuous research in order to keep the business up to date and ensure the franchisee remains ahead of the comptetion.
- The franchisor has the benefit of market information and experience from all its franchisees. This accelerated experience is disseminated to all franchisees allowing them access to otherwise unobtainable information.

Of course as with any deal there are also disadvantages. Franchising is no exception and the following are among the major disadvantages of being a franchisee.

- As a franchisee certain controls are imposed relating to the nature and scope of the work you may do, and also the standards to which you have to operate.
- Any services rendered by the franchisor usually have to be paid for.
- It is difficult as the small partner to assess the quality of the franchisor, and even more difficult to enforce any desired changes. There is also no guarantee that the franchisor will continue to operate at his current standard or even at all.

- There will be restrictions on franchisees relating to the sale or transfer of the franchisees business whilst operating within an agreement.
- There is a danger of becoming over dependant on the franchisor. This could, besides affecting the franchisees motivation and initiative, also leave him high and dry should the franchisor cease to perform.
- Once tied into an agreement the franchisors actions and policies may adversely affect the franchisees profitability.
- The franchisor may make fundamental policy decisions which are detramental to the franchisees business.
- The good name and reputation of the franchised business may become less reputable over time through no fault of the individual franchisee who will suffer as a result.

1. Mendelsohn, M. The Guide to Franchising; 3rd ed. (London, c. 1982). P. 14.

2. "Why franchising works". Opportunities in franchising - standard Bank of South Africa Limited - Small Business Development Publication; (Johannesburg, 1982), P. 2.

3. Vaughn, C.L. Franchising; 2nd ed. (Toronto, 1979), PP. 18 - 19.

4. Ibid., P. 19.

5. Quelch, J.A. "How to Build a Product Licencing Program." Harvard Business Review, May - June, 1985. No. 3, PP. 186 - 188.

6. Franchise Opportunities Handbook; Bureau of Industrial Economics and Minority Business Development Agency. (Washington D C, Sept. 1982).

7. Mendelsohn, op. cit., P. 6.

8. Ibid., PP. 10 - 11.

9. "Franchising - A Growing Trend in South Africa". The New Retailer, Feb. 1983.

10. Siegal, W.L. Franchising; (London, 1983), P. 12.

11. Vaughn, C.L. op. cit., P. 206.

12. Mendelsohn, op. cit., P. 116.

13. Vaughn, C.L. op. cit., PP. 205 - 219.

14. Ibid., P. 63.

15. Mendelsohn, op. cit., PP. 22 - 26.

CHAPTER THREE

THE RESEARCH STUDY

3.1 Design and Methodology of the research

The growth potential of franchising as a concept in the building industry, as well as its importance with respect to industrialised and innovative methods, was discussed in Chapter 1. Out of this the objectives of the research were formulated. In order to meet these objectives the following research parameters were set.

3.1.1 Research design

To satisfy the objec'ives, exploratory research as opposed to descriptive research was employed. This was appropriate as exploratory research places emphasis on the gathering of information, the clarifying of concepts and increasing the researchers familiarity with the subject,[1] in keeping with the broad objective of the research.

Of importance is the fact that when starting this research very little if any information was available on the subject. Churchill[2] outlines the flexibility allowed in exploratory research and also evidences the fact that exploratory studies of this nature rarely involve probability sampling plans.

The field study[3], being a populer small sample technique in exploratory research, was thought suitable for the main body of the research and implemented with the aid of a structured questionnaire. The study focussed primarily on two areas. First was the small group of franchisors, of whom four were thought to be operating an agreement in the sense contemplated by the research.

Secondly there were the franchisees or licensees operating in terms of the above agreements. The total population of these licensees is between 70 and 80. However, some of these companies while holding the license are not currently operating under it, and others are classified as large corporations and not entrepreneurial in the sense of the research. There are then some 43 active licensees in the sense contemplated by the research country wide.

3.1.2 Research Methodology

The information sought was as set out in the framework elaborated on in 2.3. This primary data had to be collected directly from the respondents. In the case of the franchisors, this took the form of personal discussions on a one to one basis. In the case of the franchisees the communication involved questioning the respondents to obtain the desired information using the structured questionnaire (copy filed under Appendix A).

The questionnaire itself was a structured undisguised questionnaire, i.e. the questions as well as the answers were standardised, and presented in exactly the same order to all respondents. The questions were of the fixed alternative type, designed to solicit subjective responses, purely from people operating under an agreement as defined.

All questionnaires were filled in either by the respondent in the presence of the researcher or by the researcher in the course of a telephone call. Kress as cited by Collins[4], indicates that these constitute pure methods of administering a questionnaire. Also as explanations were required in certain cases, this saved repeated contact with the same individuals.

The sample itself was purposive as discussed by Churchill[5] and non probabalistic in nature. This was in keeping with the judgemental nature of the research. The sample elements were hand picked because it was expected they could best serve the research purpose. Of the 43 active franchisees, 21 responded, giving an apparently representitive sample by both market sector and geographic area as indicated in table 4.

To gain a clear picture of who the licensee respondents were, certain informative questions were asked under Section A of the questionnaire. The breakdown of respondents is as follows:

Table 1: Position of respondent in licensee company

Position	No.	%
Managing Director	8	38
Director	5	24
Owner	3	14
Partner	3	14
General Manager	1	5
Manager	1	5
TOTAL	21	100

In keeping with the scope of the research, all respondents represented entrepreneurial operations. All positions such as Managing Director, must be viewed in the light of them being small, unlisted private companies, and one should not envoke the idea of large companies being represented.

Table 2: Annual turnover of licensee company

Annual Turnover	No.	%
< R500 00	5	24
500 000 - 900 000	5	24
900 000 - 1 000 000	4	19
R1 000 000 - plus	3	14
No answer given	4	19
TOTAL	21	100

Table 3: Number of people employed by licensee company

Number of employees	No.	%
0 - 10	6	28
10 - 20	6	28
20 - 30	4	19
30 - 50	0	0
50 - 100	1	5
> 100	2	10
No response	2	10
TOTAL	21	100

Table 4: Respondent breakdown by sector

	Componentised construction	Timber frame	Insul-ation	Roofing
Transvaal	1	4	1	5
Cape	1	0	0	5
Natal	0	1	0	2
O.F.S.	1	0	0	0
Sample total	3	5	1	12
Total No. of licensees	10	13	3	17

Of the Respondents, 18 (86 %) indicated that they were fully aware of the implications of a licensing agreement. The other 3 (15 %) were not 100 % satisfied that they weren't being misled to some degree.

Significantly 19 (90 %) of the respondents felt that license or franchise agreements were applicable in the building and construction industry as a whole. Also 18 (86 %) of the respondents felt that the system was particularly acceptable to the company which they represented.

Overall then the respondents were holders of key positions in small operations having a fairly high turnover to employee ratio. The initial response was also that they understand the concept and agree that it is applicable in the industry.

Although no quantitative measures can be used to determine the accuracy of this sample it is thought to be sufficiently representative to produce accurate results.

The research findings are presented in two sections. Firstly the findings on agreements operating in the building and construction sector are discussed within the framework set out in 2.3. Secondly the results of the attitudes expressed via the questionnaire are presented in tabular form. Because of the small sample used the calculations were performed manually. The results of each outcome are then reviewed and observations are made based on information gained during the research.

3.2 Agreements operating in the building and construction industry

Although there were many operations within the defined market which claimed to operate at least under a licensing system, only four were found to be operating under a physical agreement containing terms and conditions in the true sense.

All four operations have the franchisor, a company which is part of a large organisation or group of companies. All the agreements are operated and monitored by either marketing services or technical services divisions, and all cover as their main object the licensing or franchising of a "service", i.e. both the product and blueprint method of using, erecting or installing that product.

The other systems in operation consist mostly of rough "approval" systems, often not even having a token certificate or card indicating that the contractor is approved by the supply company. This is true for both product only as well as "service" operations.

In assessing the agreements, they are studied in the agregate under the provisions of contract set out in 2.3. Where specific provisions are contradictory or exceptional, these are highlighted. Again it is emphasised that only the areas of principle are being studied and not areas of a legal or technical nature.

3.2.1 General Provisions

3.2.1.1 Description of the parties

Besides the names and addresses of the parties it is interesting that three of the agreements have specific terms relating to access to facts reasonably related to the business qualifications of the potential licensee as well as his technical qualifications. In the fourth case it was stated that although not a specific clause, it was definately an implied pre-requisit to the granting of the license. In one case there even exists a licencee "audit" form, consisting of specific marketing, financial and technical standard questions as a separate sheet.

3.2.1.2 Nature of the franchise

All four agreements are for a specifc period of time (ranging from three to twleve years). None of the agreements stipulate obligatory use of the licensors name. There are however terms in two of the agreements stipulating that although the contractor continues to use his own name, he has to identify himself as a licensee in a specific manner.

3.2.1.3 Territory

In no case is there a specified area of operation laid down by the licensor. In one agreement there is a "licensed area", which is specified by the licensee. The only qualification is that once this area has been specified, no matter how large it may be, the licensee is then obliged to work "within" and "throughout" that area. All the licenses are also completely non-exclusive.

3.2.2 Starting up Provisions

3.2.2.1 Deposit of fees

Two of the agreements stipulate an up front fee which is payable on signing. This is to cover administration, training and the like. The third stipulates a minimum capital requirement and the fourth has no financial implication up front at all.

3.2.2.2 Land, Buildings, Equipment and Facilities

In only one case is inspection of premisis and approval of these and the equipment therein stipulated. The others are very open and allow the licensees to operate literally from anywhere.

There is also only one agreement which stipulates the use of colours and logos on buildings and vehicles.

3.2.2.3 Training

Training in the proper provision of the licensed service is very specific in all cases. This covers initial and ongoing training both in house and on site. Training is one of the most important aspects and as one of the interviewees stated, "the granting of the license indicates trained."

Interestingly in two of the agreements there are provisions for the potential licensee to have already done a certain amount of work to the correct standard before being accpeted. In the third case there is provision for issuing a temporary license during which period the licensee has to prove his ability.

3.2.3 Operating Provisions

3.2.3.1 Assistance in Purchasing

Three different situations exist with regard to assisting licensees in purchasing. The first case is where the material is supplied only to licensees who perform the licensed services. The second, which is part of two of the agreements is that the licensees are given preferential discounts and granted credit facilities. In the third case the licensees are given no preference whatever and are not granted credit. This company is of the opinion that being allowed to use their system is advantage enough for the licensees.

In all cases the licensors are the sole manufacturers of the respective products so there is no problem with specifying approved suppliers. Licensees can purchase from merchants instead of the mother company in cases of emergency, but preferential discounts are waived in this case.

3.2.3.2 Guidance in Bookkeeping

In two of the agreements there is a stipulation regarding the method of accounting. This relates to eneuring proper control over the amount of product purchased and the payment of royalties or fees which are based on purchases. The other two agreements do not involve this aspect at all.

3.2.3.3 Management and Promotions

Only in one agreement is there provision for assistance in managing and running the franchisees business. A fee is payable if this service is used. This agreement also provides for specific payments in terms of advertising and promotional material on an ongoing basis.

The other three agreements have no such provisions at all although these services are provided on an ad hoc basis as required.

3.2.3.4 Recommendations on sales

There are limitations in all the agreements regarding the provision of the services only in terms of the technical and performance specifications laid down, (whether these be Agrèment Certificates or internal standards).

No attempt is made in any of the agreements to set or dictate selling prices. This is because the licensees services are sold on a tender and contract basis in competition with other methods of doing the same job, and conditions vary from contract to contract.

3.2.3.5 Performance by the franchisee

In all cases the service must be carried out by the licensee only. Sub contracting is allowed under certain conditions to qualified people, but the licensee remains liable. In two of the agreements there are stipulations regarding minimum levels of work to be carried out per month. The other two have no such clauses.

All agreements state specifically that all sites where the licensed services are being carried out must be accessible to the licensor, and where applicable to the Agrèment Board, for the purpose of inspection.

3.2.3.6 Reports and Royalties

Activity reports are required by all the agreements. These include current and forthcoming contracts being done by the licensees and test results where applicable.

Purchases, royalty paymetns and advertising expenditure are also reported on.

3.2.3.7 Confidentiality

All four agreements contain clauses covering confidentiality of disclosures by the parties and trade and technology secrets.

3.2.4 Termination

3.2.4.1 Renewal of terms

Interestingly only one of the agreements makes specific provision for renewal at the option of the licensee. All the others have nothing, but the people in control suggest this would be by negotiation and reappraisal. The reason why three of the four agreements have no such provisions is to allow them to get out of a relationship they no longer wish to continue.

3.2.4.2 Transfer of Rights

Although all the interviewees were very emphatic that any transfer of rights or obligations or any cession or assignment or change of ownership would terminate the agreement, only one agreement specifically addressed the problem.

3.2.4.3 Termination for Cause

All four agreements set out clearly the licensors right to terminate if the licensee should default on his obligations. These provisions relate to poor workmanship and the failure by the licensee to make any payments due whether for royalties or for product purchases.

3.2.4.4 Termination without Cause

Not one of the agreements addresses the problem of one of the parties wanting out, even though there may be no substantial breach by either party. All interviewees said this would not be a problem and could be negotiated. However if one party was gaining specific advantages he could, as the agreements stand, force the other party to honour the agreement to the expiry date.

3.2.4.5 Obligations on Termination

Again although everyone expressed the view that all parties knew what would happen on termination, only one agreement spelled out the parties obligations. These relate to the returning of logos and identification marks, restraint of trade and rights to repurchase material from the licensee, and also to take over existing and outstanding contracts and to re-allocate these to other licensees.

3.2.5 Requirements of the Authorities

In this case the authorities are the testing and control authorities, viz. the Agrèment Board of the C.S.I.R and the local or municipal authorities.

The Agrèment Board defines two systems of industrialised building. These are the "open" and the "closed" systems. The open system is where components are available for purchase and erection by anyone. This system is stated to be unsuited to the Agrèment certification system because of the inconsistency of erection or installation, and the consequent lack of assurance of a standard of performance of the finished product.

Closed systems on the other hand, require installation to a set procedure and standard. Such systems are said to be perfect for Agrèment certification and for licensing of the service (product plus method).

In terms of the National Building Regulations[6] such guaranteed finished product service has to be allowed by the local authorities (except under certain defined circumstances), for the provision of housing or other buildings, provided the service carries the Agrèment certificate.

3.2.6 Evaluation and Conclusions

Out of the evaluation of the agreements in operation and the requirements of the authorities, there are several observations to be made.

- In all cases the licensor is the sole producer of the particular product being licensed. He also has exclusive right to the method of installation or erection of that product, i.e. the blueprint as set out in both his own and the Agrèment conditions. While this would seem monopolistic, it must be remembered that there are products in all cases which, although different in substance and technique , offer the same or similar performance criteria and may be easily substituted.
- In all cases the agreement is entered into on the basis of technological competence. The prime objective of the licensor is the implementation and control of standards in the market place using closed systems.

- In no case is the making of money over and above profit on sales of the product, the reason for operating an agreement. Where lump sums or fees are payable these are to cover direct costs of advertising and lead generation, administration, training and similar costs necessarily incurred.
- All the agreements are biased in favour of the licensor in terms of checking and acceptance of the other party. In no case is there provision for the licensees to be allowed to check on the integrity or financial position of the company granting the license. The indication from all companies was that no information of this nature would be divulged.
- In keeping with the aspect of granting the license for technical competence, training is mandatory in all cases and the change of beneficial ownership of the licensee constitutes a loss of competence which is a cause for termination.
- A peculiarity of three of the four agreements lies in the fact that licenses have been granted to many licensees where actual performance of the service has not been enforced. This has resulted in the existance of many "dormant" licensees. These people have in fact bought the licence only as an option to be taken up when the market or competitor situation warrants. Most of these licensees have actually undertaken prototype work and then shelved the systems. There is therefore a relatively large potential number of operators in comparison to those currently operating, given the right circumstances.

3.3 Evaluation and discussion of the questionnaire

The following information relates to the responses given by the respondents as defined under 3.1.2 to the questionnaire (Appendix A). For ease of reference the sequence follows the theoretical outline set in 2.3 and the questions in Appendix A.

3.3.1 General Provisions

The provisions in this section relate to the potential licensee and cover the major areas he will want to know about before signing.

As with all the sections of the questionnaire the results are the expression of the licensees subjective opinion. They often d. not reflect his actual circumstances but rather his desired circumstances, and as such are pointers to what would constitute a marketable agreement among prospective licensees.

Table 5: Disclosure of information

Before signing a licensing agreement is it fair that facts relating to the financial position and history of the licensee (including interests in other businesses)

	No.	%
a) be demanded by the licensor.	3	14
b) be disclosed only if they are relevant to the agreement	13	62
c) remain secret to the licensee.	5	24
TOTAL	21	100

Often potential licensees are already in some other business and the fact that 13 respondents (62 %) would only divulge "relevant" information is significant. There exists a great feeling that this is their business and the licensee has the right to remain secret. When looking at Table 14, this point is emphasised where with regard to operating accounts 52 % of the respondents were willing to give at most summary documents and 38 % no accounting information at all. This is perhaps typical of the smaller business operation.

Table 6: Identification of the licensee

When operating under license should the licensee

	No.	%
a) be obliged to operate under the licensors name and forego his own identity.	1	5
b) operate under his own name but be obliged to identify his business as one licensed to the licensor.	14	67
c) retain his original identity and have no tie back to the licensor.	6	28
TOTAL	21	100

In line with the attitude expressed in the previous table, only one of the respondents would be prepared to forego his own name and operate under the name of the licensor. This again relates to the fact that in almost all cases the licensee is an established and operating concern at the time of signing the agreement. The attitude expressed was that a lot of personal time and effort had gone into building up the name and thus was not easily going to be given up. Significantly however, 14 of the respondents (67 %) indicated that they would not be averse to being identified as a licensee and enjoying the effects of being associated with the licensors name and advertising. This correlates with Table 16 where 72 % of the respondents expressed that joint advertising and promotional contributions were favoured.

Table 7: Period of the agreement

Should the period of the agreement be

	No.	%
a) in perpetuity.	2	10
b) renewable/cancellable at the option of either party.	14	66
c) for a fixed period only.	5	24
TOTAL	21	100

The results of Table 7, are compatable with the general scepticism expressed by all licensees. All felt that the agreement was by the licensor for the licensor and therefore the majority of 14 (66 %) of respondents wished the agreement to be renewable or cancellable at their option. Also 5 (24 %) wished the agreement to be only for a fixed period (in case something went wrong or they changed their minds). Table 33 agrees with these figures and 66 % of the respondents agreed that the agreement should be cancellable by mutual agreement. In general the feeling was that there should be nothing in an agreement which could allow the licensor to force performance to the end of a period of time if the licensee wanted out.

Table 8: The licensed area

Should the area in which the licensee may offer his service be

	No.	%
a) specified by the licensor.	1	5
b) negotiated by both parties.	4	19
c) not be limited (i.e. the licensee may compete for business whereever he likes on an open market basis).	16	76
TOTAL	21	100

Because of the contractual nature of the services performed, the cyclical nature of the industry, and the fact that most of the licensees will obtain work wherever they can, it is probably not surprising that 16 (76 %) of the respondents preferred not to have a definate area of operation specified. Also because ofthe non exclusive nature of the agreements there is no protection afforded by having a specific area of operation. The 4 (19 %) who responded that the area should be by agreement meant that the agreement would include a degree of exclusivity.

Table 9: Restriction on activities

Should a licensee be restricted to

	No.	%
a) only carrying out the licensed services.	1	5
b) carrying on the licensed services as well as any other business agreed to by both parties.	8	38
c) not restricted at all.	12	57
TOTAL	21	100

Once again the nature of the potential licensee is expressed in the answers in Table 9. While 12 (57 %) of the respondents voted for total freedom of operation, it is important that 8 (38 %) acknowledged that the carrying on of business other than that under the license should be negotiated. The indication is therefore that while most of the licensees see the subject of the license as "another way" of making money within the industry, there are a good percentage who realise that in order to succeed in providing the licensed services, proper attention must be devoted to them. The second aspect of course relates to the syphening off of funds from one business to another. If this happens and the licensed business goes under as a result; the image of the service suffers. While there is some understanding of this the overall attitude is that the licensee needs to keep his options open in the event of the market dropping or the licensor retracting or himself going out of business.

3.3.2 Start up Provisions

Start up provisions relate to the rights and obligations to which the licensee will become subject on signing the agreement. Opinions expressed relate to the degree to which a licensee, being the type of person or company he is, is prepared to be dictated to by the licensor and the degree to which he will accept conformity.

Table 10: Up front Payments

Given the nature of the building industry is it fair that the licensor should demand

	No.	%
a) an up front fee for the use of his name, products, expertise, etc.	2	10
b) a minimum capital investment by the licensee in his business to ensure stability.	10	47
c) no fee at all.	9	43
TOTAL	21	100

The biggest number, i.e. 10 (47 %) of the respondents acknowledged that if starting to operate as a licensee, a minimum capital investment is required to ensure stability in the business. Another 9 (43 %) however felt that there should be no fee stipulated at all. The reason why 19 (90 %) of the respondents in total were not in favour of a straight lump sum payment for the use of the licensors name, logo, etc. was twofold. Firstly they all said that the licensors remuneration should come from the purchase price of the products sold, and secondly that they had to become qualified in the provision of the licensed services so that it was their skill and not the licensors name which was important. The fact that the initial or ongoing fees may be built into the selling price of the products was of little concern.

Table 11: Premises and Vehicles

Having signed the licensing agreement should the licensee with respect to his premises and vehicles

		No.	%
a)	be forced to use the stipulated colour schemes, logos, etc. of the licensor immediately.	1	5
b)	be given time to phase in the above.	10	47,5
c)	be allowed to continue operating using his own colours, logo, etc.	10	47,5
	TOTAL	21	100

This table indicates that 20 (95 %) of the respondent licensees would not be forced into using stipulated logos and colour schemes. Despite the indications in tables 5 to 9, of the independant nature of the licensees, 10 (47,5 %) said that given reasonable time they would be happy to phase in colour schemes, logos, etc. These respondents tended to be mainly the smaller operations who at this point acknowledged that there may be some mileage to be got out of the licensors better known name and image. The other 10 (47,5 %) who were not prepared to forego their own image were those bigger licensees who felt that their own identity had been well enough established in their main areas of operation not to require the crutch of a mother organizations backing.

Table 12: Licensed Premises

Should the premises from which a licensee operates be

	No.	%
a) stipulated by the licensor.	0	0
b) decided on by negotiation.	3	14
c) left to the choice of the licensee.	18	86
TOTAL	21	100

Stipulations on where the licensees may or may not operate from raised the biggest objections. The reason why 18 (86 %) of the respondents insisted on choosing their own premisis was the effect of the overhead burden of the wrong premisis on a small operation. Many of the respondents operate from extremely low cost premisis or from home. This allows them to cut prices to the most competitive level. Obviously this is of particular significance under the prevailing economic conditions.

Table 13: Training

Should product and installation techniques training (both initial and ongoing), be

	No.	%
a) compulsory at the insistance of the licensor for all licensees.	10	47,5
b) compulsory for new licensees only.	10	47,5
c) provided only at the request of the licensee.	1	5
TOTAL	21	100

It appears that the appreciation of the requirement for training is very widespread. Of the respondents 10 (47,5 %) thought that this should be compulsory both initially and on an ongoing basis. The concern expressed was that if the standard of the service was seen to be deteriorating, or the performance of the end product came into disrepute, each contractor would be adversely affected. Also there has to date been the fear with the largely unaccepted innovative methods and materials being used that any breach of confidence could mean the demise of the system, and the licensees along with it. This concept or fear is confirmed by the fact that a further 10 (47,5 %) of the respondents stated that training be compulsory for new licensees in the system.

Table 14: Maintenance of Standards

Is it fair, with regard to the maintenance of standards, that the licensee be required to provide proof of his competence in providing the licensed services

	No.	%
a) both initially and on an ongoing basis.	12	57
b) initially only.	8	38
c) not at all.	1	5
TOTAL	21	100

Table 14 serves to ~~corroborate~~ and reinforce the attitudes expressed in Table 13. In fact the implications of this table go even further than those of the previous table. Here 12 (57 %) of the respondents agree that they should be subject to both initial and ongoing tests proving their continued competence in providing the licensed services. Also, with or without compulsory training, a further 8 (38 %) of the respondents thought that proof of competence should only be required initially, but should nevertheless be required. The reasons for this are again twofold. Firstly the certified competence is a marketing tool, and secondly the proof of competence is seen as an entry barrier for new commers, thus maintaining something of a closed shop from the point of view of the licensees.

Table 15: Application of standards

When the product or service being licensed is subject to third party controls, e.g. Agrèment Board certification, should these controls (standards) be

	No.	%
a) enforced by the licensor in all cases.	11	53
b) applied with discretion after negotiation between the parties.	7	33
c) not be strictly applied where the licensee has proven expertise in providing the licensed service.	3	14
TOTAL	21	100

The attitudes expressed in Table 15 are again complimentary to the preceeding discussions. While the 11 (53 %) respondents saying that third party controls should be enforced are doing so for their own protection, there is a second element worth commenting on. This is the 7 (33 %) of the respondents who form the "old guarde". These are contractors, mostly of long standing, who have developed better ways of doing things than those laid down and do not want to be caught out. They therefore advocate that discretion and negotiation replace enforcement.

3.3.3 Operating Provisions

The operating provisions as set out in the questionnaire define the day to day and year to year general running of the licensed services in terms of each particular agreement. Because each licensee operates under a separate set of circumstances, there are certain clashes of opinion, and very few really clear cut preferences, except where the provision is a definite carrot for the licensee.

Table 16: Preferential treatment in purchasing

Given that the licensee has certain obligations under the agreement, should he in terms of purchasing, credit facilities and discounts

	No.	%
a) be given preferential treatment at all times.	15	71
b) be given preferential treatment only on special contracts.	2	10
c) be treated the same as any other customer depending on purchase volume etc.	4	19
TOTAL	21	100

While it was to be expected that the great majority of 15 (71 %) would be of the opinion they should receive preferential treatment at all times, it is perhaps surprising that only 2 (10 %) expressed the desire to be given preferential treatment for special contracts. This is the basis on which the licensors would seek to operate in meeting competition without leaving too much change on the table. It may be that the licensees are voicing displeasure at the way in which they are being treated, as often preferential treatment is only given when it is to the licensors benefit.

Table 17: Sources of Supply

Given that shortages may occur in the building industry should the licensee be

		No.	%
a)	obliged to purchase from the licensor only and e.g be rationed if necessary.	5	24
b)	given a list of "approved"-suppliers.	10	47
c)	allowed to select his own sources of supply.	6	29
	TOTAL	21	100

Given the fact that in all the agreements under discussion the licensor is the sole manufacturer of the product in question, it may appear strange that 10 (47 %) of the respondents indicated they should be given a list of approved suppliers. The implication here is that in all cases the products are also available through distribution networks, and what the licensee really wants is to be able to purchase from his nearest distributor at the same price as from the supplier. The 6 (29 %) who indicated they should be allowed to select their own source of supply were presumably motivated by the same reasoning, knowing that there is only one supplier.

Table 18: Books of Account

Should the licensee be obliged with respect to books of account and financial standing to

	No.	%
a) deliver to the licensor all information demanded whether on prescribed forms or otherwise.	2	10
b) Deliver only summary documents such as balance sheets for inspection.	11	52
c) Maintain secrecy on all such matters.	8	38
TOTAL	21	100

As discussed under Table 5, the licencees are very reticent when it comes to disclosing financial information. It is no surprise therefore that 8 (38 %) of the respondents would wish to maintain total secrecy regarding their affairs. The chief reason for seeing no reason to disclose their affairs revolved around the purchasing pattern. Where licensees purchased products for cash and owed no money, they felt the licensor had no right to delve. Also as fees payable were based on material sales there was no need for audited statements.

The fact that the majority of 11 (52 %) were prepared to give summary documents indicates, an acceptance that the information supplied is agreed to be of importance in certain circumstances, but that secrecy is still the key.

Table 19: Management and Administration

Should assistance with regard to administration and management of the licensees business

	No.	%
a) be obligatory at the insistance of the licensor.	0	0
b) be imposed only in certain special cases.	8	38
c) be available at the request of the licensee only.	13	62
TOTAL	21	100

The results of Table 19, show conclusively that no one is prepared to have his business run for him and this is expressed by a zero response to the "obligatory" statement. There does appear by the fact that 13 (62 %) of the respondents indicated that the services should be available on request, that the licensees appreciate the fact that things can go wrong and that they would like the assurance of the mother companies assistance when required. This is a kind of insurance policy attitude.

Table 20: Advertising and Promotion

Should advertising and promotion of the licensed service be concucted

	No.	%
a) by the licensees only and at their own cost.	3	14
b) by both parties and from joint contributions.	15	72
c) by the licensor only at his own cost.	3	14
TOTAL	21	100

Although there has been a very strong feeling expressed that the licensees wish to run their own show, the majority vote of 15 (72 %) was in favour of joint advertising contributions. This indicates an acceptance that the licensor company has the muscle and reputation to gain more business for the licensees. It was said by numerous respondents that they had got unsolicited business purely because of the licensor company's advertising. The dissenting votes were split evenly with 3 (14 %) each in favour of the licensee only and the licensor only paying for advertising.

Table 21: Nature and scope of Work

Should the nature and scope of the work to be carried out under license be

	No.	%
a) dictated by the licensor.	6	29
b) negotiated on a contract for contract basis.	8	38
c) left to the licensees discretion.	7	33
TOTAL	21	100

A complete split of opinion was evident in Table 21. The 6 (29 %) who expressed the opinion that the nature and scope of the work performed should be dictated by the licensee did so for a specific reason. This was that the licensed service was a technological one within the limits set down by the Agrèment Board or the licensor. It was the specific approved method which was the basis, and the fact that anyone who did not adhere to the stipulations would be singled out was seen as a form of protection to licensees in good standing.

The reason why 8 (39 %) voted for negotiation on a contract for contract basis was that while the licence may e.g. be for erecting single story buildings using the licensed system, the individual licensees had built double story buildings successfully and felt they should be allowed to exceed the terms of the agreement where they felt competent.

The 7 (33 %) who were of the opinion that the nature of work done should be at their own discretion felt that although they were licensees, it was after all their business and they should be allowed to take the risks. This is in conflict with the licensors objectives.

Table 22: Selling Price

Should the selling price of the licensed services be

	No.	%
a) dictated by the licensor.	1	5
b) negotiated by the parties on a contract for contract basis.	4	19
c) determined by the market.	16	76
TOTAL	21	100

Free enterprise is the name of the game as expressed in Table 22. Here 16 (76 %) of the respondents agreed that the market should determine the price. Those 4 (19 %) who preferred negotiation on a contract for contract basis did so with the view that additional discounts should be obtained on large or prestigeous contracts.

The idea of forming cartels or price floors was rejected outright. The reason was that there was no area exclusivity, and licensees actually competed among one another. There was a distinct lack of trust among licensees.

Table 23: Sub-contracting

Given that a license of this nature is generally granted for a service, i.e. product plus installation, should the licensee

	No.	%
a) be obliged to perform the total service himself.	6	29
b) be allowed to engage sub-contractors.	11	52
c) be allowed to sub-contract and sell the product on the open market as a distributor.	4	19
TOTAL	21	100

The same number of respondents viz. 6 (29 %), as expressed the view that the nature and scope of the work be dictated in Table 22, expressed the view that they should be obliged to do the work themselves.

The use of sub-contractors to perform the licensed services was advocated by the majority of respondents. The 11 (52 %) who answered this way, acknowledged that total responsibility for the service provided should vest in them as the licensee, and that sub-contracted work must be open to the same scrutinizing and rules as any other.

Table 24: Limitations on licensee size

Should there, in the interest of control and maintenance of standards

	No.	%
a) be a limit imposed on the size of the licensees operation.	2	10
b) be limits imposed only in cases where the licensee has become unstable.	10	48
c) be no controls imposed.	9	42
TOTAL	21	100

An interesting dichotomy is evident in the attitude of licensees to the limitation on the size of business they should be allowed to operate under the license agreement.

Table 25: Levels of Activity

Given the nature of the industry is it reasonable for the licensor to stipulate

	No.	%
a) minimum levels of activity.	9	42
b) continued and uninterrupted provision of the services.	4	19
c) minimum initial orders only.	8	39
TOTAL	21	100

It may at first seem strange that the majority of 9 (42 %) of the respondents actually think that minimum levels of activity should be imposed. Again the logic is however simple and protectionistic. If the minimum level is set at a fairly high level then no small operation who cannot maintain the level will be granted the license. Also if the licensee is one of the people who generally exceeds the minimum, and the market turns down, he will not be repremanded as everyone else's level of activity is likely to be relatively as low.

The reason for a further 8 (39 %) of the licensees indicating that there should only be an initial order quantity stipulated is the same except that they feel once you're in the club you should be left alone.

Table 26: Third party inspection

Given the contractual nature of any licensed services, should the licensor or other third parties to the carrying out of the services (e.g. the Agrèment Board) be

	No.	%
a) allowed unlimited access to sites where work is in progress or complete.	15	71
b) allowed access only after requesting permission (which may be denied).	4	19
c) allowed access only at the request of the licensee.	2	10
TOTAL	21	100

The views expressed in Table 15 are reinforced by the results of Table 26. While 15 (71 %) of the licensees agree to unlimited access, a further 4 (19 %) agree that they would allow access but on request. This makes 19 (88 %) of the respondents amenable to inspection. The logic is that if the inspections are done thoroughly then the fly night operators will be eliminated in time, thus ensuring the continuation of a fairly closed shop operation.

Table 27: Activity Reports

Should it be obligatory for activity reports regarding contracts to be undertaken in terms of the license agreement , to be

	No.	%
a) submitted before any contract is commenced for approval by the licensor.	4	19
b) submitted on a periodic basis indicating contracts completed and forthcoming .	7	33
c) submitted only on special request by the licensor.	10	48
	21	100

The view was expressed that the filling in of reports was a waste of time. Also that there were certain contracts that the licensee did not wish for whatever reason to divulge. These views are borne out by the fact that 10 (48 %) of the respondents would agree to undertake activity reports on special request and a further 7 (33 %) only on a periodic basis.

These results correlate with Table 18 where only 11 (52 %) of the respondents would deliver even summary accounting documents. There is however an apparent conflict of opinion to that expressed e.g. in Table 26. Everyone wants the protection of The Agrèment Board approval and inspection but only 4 (19 %) are prepared to tell you where they are to carry out the licensed services.

Table 28: Payment of Royalties

Should the payment of ongoing royalties or fees in respect of the agreement be paid to the licensor.

	No.	%
a) as a matter of course as payment for the use of his name, product, goodwill etc.	1	5
b) only in respect of specifically justifyable expenses such as advertising or the provision of management services.	11	52
c) not under any circumstances.	9	43
TOTAL	21	100

Only 1 (5 %) isolated repondent indicated that he would be willing to pay royalties in the true sense of the word. The majority of 11 (52 %) of the respondents indicated that fees to be paid on an ongoing basis for a justifyable cause would be acceptable.

Some respondents were obviously unclear about their stand on payments of this nature because while 9 (43 %) indicated here that they were not prepared to pay under any circumstances, 15 (72 %) had already indicated willingness to pay towards advertising and promotions in Table 20.

3.3.4 Termination Provisions

Termination provisions relate to the fate and obligations of the licensee, should the agreement either run its course, or be terminated either with or without cause. There are also certain rights which the licensee will want to ensure depending on the circumstances of the termination.

Table 29: Renewal of the agreement

Given that the agreement is for a fixed period should it be renewable

	No.	%
a) at the option of the licensor.	1	5
b) by negotiation between the parties.	18	85
c) at the option of the licensee.	2	10
TOTAL	21	100

The overwhelming vote of 18 (85 %) was for the "reasonable" route, i.e. renewal of the agreement by negotiation once it has lapsed. The opinion was that if renewal was at the licensees option and the licensor was not in favour, then the licensee would in any event not have a happy or successful second term. The same applied to the reverse situation of renewal of the licens: rs option. If there could not be agreement there would not be co-operation and the system would fail.

Table 30: Cession and Assignment

Should the licensee be allowed to cede or assign any of its rights or obligations in terms of the agreement

	No.	%
a) unuer no circumstances.	3	14
b) only with the licensors permission.	15	72
c) as and when he sees fit.	3	14
TOTAL	21	100

Table 30 shows that altogether 18 (86 %) of the respondents agreed that there could be no cession or assignment, at least without the approval of the licensor. This result is however more as a fear of incurring the wrath of the licensor than out of a knowledge of the law.

Table 31: Change of ownership

Should the change of beneficial ownership or membership of the licensee company

	No.	%
a) constitute automatic cancellation of the agreement.	8	38
b) be allowed subject to the approval of the licensor.	8	38
c) be allowed in all cases as it is the licensees business.	5	24
TOTAL	21	100

There exists an acute appreciation among the licensees of the fact that the license is granted largely because of the expertise of the management existing in the licnesee business. Also there is an understanding of the fact that any change in the beneficial ownership of the licensee business may strip it of its expertise and competence.

These views are supported by the fact that 8 (38 %) of the respondents agreed that such a change should constitute automatic cancellation, and a further 8 (38 %) indicated that only on approval of the licensor should this be permitted.

The general approach was that should such a change take place then the licensed operation should in any event be open to reappraisal by the licensor.

Table 32: Restraint of trade

Where an agreement is terminated because of a breach by the licensee, should restraint of trade agreements be allowed

		No.	%
a)	as a matter of course.	2	10
b)	in special circumstances only.	9	42
c)	under no circumstances as this is the licensees only method of earning a living.	10	48
	TOTAL	21	100

A very guarded reaction was received to the question of restraints of trade. As can be seen 10 (48 %) of the respondents could not agree with restraints under any circumstances because this was their only means of earning a living. A further 9 (42 %), while being against restraints, agreed that they may be applicable in certain circumstances including things such as criminal convictions which may bring the whole licensee network into disrepute.

Table 33: Cancellation of the Agreement

Should the agreement be cancellable

		No.	%
a)	at the option of the licensor.	2	10
b)	by mutual agreement.	14	66
c)	at the option of the licensee.	5	24
	TOTAL	21	100

The reaction to the question of cancellation was more cautious than that to renewal of the license. In this instance while 14 (66 %) agreed to cancellation by agreement, a smaller number of 5 (24 %) would like to be able to councell at their own option. This was purely in case of not liking what they'd signed for, the licensees felt they needed an escape route.

Table 34: Returning of Material

On termination for whatever reason, should the licensee be obliged to

	No.	%
a) return all signage, material etc and cease trading under his current name.	5	24
b) return all signage but be allowed to continue to trade under his own name.	11	52
c) be allowed to continue business as usual and forfeit only favourable discounts etc enjoyed as a licensee.	5	24
TOTAL	21	100

It is interesting that whilst being anti-restraint of trade in Table 32, there were still 5 (24 %) of the respondents who agreed to forfeiting their company name on termination of the agreement. On the other hand there were 5 (24 %) who were only prepared to forfeit their favourable discounts even if they had perpetrated a misdemenour which resulted in the termination. Again however the majority followed the middle path and 11 (52 %) agreed that they would return all signage and license related material but continue to operate under the same name.

1. Collins, M.J. "An Evaluation of Franchising for franchisees in the food Business." M B A Dissertation, Univ. of the Witwatersrand, 1983. P. 18.

2. Churchill, Jr. G.A. Marketing Research, Methodoligical Foundations; 2nd ed. (Wisconsin, 1979), PP. 48 - 50.

3. Ibid., PP. 62 - 65.

4. Collins, op. cit., P. 23.

5. Churchill, op. cit., P. 301.

CHAPTER FOUR

CONCLUSIONS AND RECOMMENDATIONS

4.1 Introduction

Based on the research findings of the previous chapter, conclusions need to be drawn in two areas. The first of these is whether in in fact the type of agreements which have been studied actually constitute franchises in the normal sense of the word, and how and where they differ from a standard commercial franchise as it is commonly known. The second area of interest is in summarising the issues raised by the research into a guideline or proposal for the form which a franchise agreement in the construction industry should take in order to be both beneficial and marketable. Recommendations are then made, based on the conclusions arrived at as to what further research requires to be carried out in order to more fully understand the problem, and a question is then raised on the future direction of franchise agreements in the building and construction industry.

4.2 The standard commercial franchise agreement versus those operating in the construction industry - The points of difference

It will have been noted in Chapter three that the term licensing and its derivitives were used in a loosely interchangeable fashion with the word franchising. This was because the licensees know and understand the agreements to which they are bound, to be license agreements. The use of the word license therefore was an aid to communicating with these people. Whether the two words or concepts are synonymous is tested below.

It is useful to preface the detailed examination by quoting Mendelsohn's[1] example of the hamburger chain.

> "Take a company which manufacturers meat products which introduces as one of its new lines - a hamburger. Experience shows that hamburgers sell well and are very popular. Some bright young man in the marketing division says 'Why don't we open up our own restaurant to sell hamburgers?' - so they do.
>
> They could at that point in time, have decided to get a wide distribution for their product by entering into a licensing agreement with other meat manufacturers for the same hamburger to be manufactured according to the same recipe in various parts of the country or territory with which we are concerned. They may do this in any event. They may have a distribution network of their own or they may distribute through meat wholesalers under distribution agreements.
>
> In this case however, they have decided in addition to those traditional methods to open up a retail outlet, and they develop a limited-menu fast-food operation built around their hamburger. They have provided an additional method of exploitation of their product. They have gone direct into the retail market but they do not have sufficient, or do not wish to commit a large amount of capital to open rapidly, a chain of what could prove to be very successful hamburger bars.
>
> So what do they do? They decide to exploit the distribution of the product at a retail level by granting franchises or licenses to others who will run identical hamburger bars, modelled on exactly the same basis as the pilot operation which the manufacturer has set up. The franchisees would trade under the same name, the same format, the same procedures. They will sell the same product. A consumer should feel on entering each store that it is part of the same organisation and that the service and product is identical in each store. In other words they establish a business format franchise."

4.2.1 General Provisions

- The first major point of difference is the obligation to use the name, logo and colours of the franchisor. As we have seen the franchise agreements studied do not stipulate this and do not enforce it. Kiningham, as cited by Collins[2], states that establishing a standard identity is the cornerstone of any franchising operation. An established standardised look, he says conveys proven consistency. There is a great deal to be gained from the association with the franchising activity and easily recognisable signage becomes an essential tool for the franchisee.

In the case of the industrial licensee it is the system and product and not the name which has to be recognisable. Academically these two concepts may not be easily reconcileable.

- The well known franchising and indeed marketing quote that when it comes to franchising the three most important factors are:

  1) location;

  2) location; and

  3) location[3] is the next point of conflict.

  In the industrial agreements studied there is firstly no territorial exclusivity granted. This is a direct contradiction to franchising as it is known. In fact generally not even a specific area of operation is set out. This is perhaps the single largest point of difference between the two systems.

4.2.2 Start up provisions

- A standard franchise is entered into by the franchisor for the purpose of increasing his distribution network, propagating his name, product and goodwill and making a profit. All except the last of these reasons are present in the industrial franchise. In fact the profit motive is pushed back one level, to be made on the sale of product and not of concept. The gaining of control is the primary motivation of the industrial licensor and is his reward.

. This applies equally to the stipulation of an up front fee. In the traditional case the franchisor is selling selling rights consisting of knowledge, expertise and goodwill as opposed to the industrial licensor who is in addition selling a product and a system. The industrial stipulation of a minimum capital investment as a substitute or alternative for the up front fee would therefore seem acceptable although in strict terms there is a conflict.

- A second area of difference relates to the opening of a new franchisee who has no prior experience. In the commercial franchise this seems possible because the franchisor will give all the knowledge, back-up, expertise, etc. As we have seen however, with the proving industrial license, there is a stipulation for the of the licensees competence before being accepted. While this is a point of difference it may in fact cause the failure rate within the industrial sector to be even lower than in standard commercial franchises.
- The third point of difference relates to the granting of financial assistance. While this is done in the commercial field it has not, and the indications are that it will not be done in an industrial setting. Here the licensee is liable totally for any monies required.

4.2.3 Operating provisions

- While the bulk purchasing negotiating power of the franchisor is to the benefit of all franchisees in the normal sense, this is not so in the industrial market. There are two reasons for this. Firstly each licensee is treated as an individual, and secondly the licensor is also the supplier so that his interest is not in lowering the purchase price but rather in maintaining margins.

- Whereas in commercial franchises the advertising burden is placed squarely on the franchisor, this is not the case in industrial licensing. Here while the licensor may also advertise his product, the selling and promoting of the licensed services is left up to the licensee.
- Commercial franchises require the setting of a standard price structure. This is so the facts can be advertised and so that consistancy can be maintained. In the industrial license the nature of the sale is one of bidding for the service and generally accepting the lowest price. The fact that licensees are competing not only with themselves but also other systems excludes price setting.
- Because the industrial licensee does not perform the licensed service on his premises he has more onerous obligations in terms of reporting and inspection. This should be seen as an extension of rather than a conflict with the commercial franchise.

4.2.4 Conclusions

Several issues have been raised regarding the differences between the commercial and the industrial franchise agreement. Notwithstanding these the test as I see it should be to take Mendelsohn's quote from 4.2 and substitute for the word "hamburger" - "innovative building system/product", and substitute for "hamburger bars" - "licensed contractor". The quotation then reads exactly as if it was a licensor operation going through the motions of introducing a new system. With the industrial licensor it may in fact be even more applicable as experience has shown that where a manufacturer provides a service in competition to the contractors he supplies, there is always a problem. He is therefore forced to franchise. This is in line with Pintel & Diamonds[4] contrast of "territorial" and "licensee" franchises.

According to Marquardt et al.[5], there are four attributes of products and services which breed franchise success. These are:

- That the product is sufficiently distinctive and identifiable by brand or trade mark and consumer acceptance has reached a point where he will search out the product when it is needed.
- That the product cannot be offered along with other products and still have the same acceptance.
- That the product has unique qualities that require special handling or preparation.
- And that the product/service requires installation, periodic service and stock of locally available parts.

These attributes are all specifically applicable to indrialised and innovative building product/systems. Also the contractors or licensees own their own business, put in the necessary capital, apply a process to the product before selling it and act as principals in performing their activities. What they have is a complete business concept. Along with this the licensor is expanding his network and making the most economic use of his companies expertise.

Under these circumstances Mendelsohn[6] acknowledges that he is of the view that the business format franchise is analgous to the licensing agreement.

The conclusion then is that while there are certain major areas of diversion, the license agreements studied qualify as franchises in the broadest sense.

4.3 Guidelines for Industrial Franchises

Set out below is a guideline on how the provisions contained in an industrial franchise agreement should be structured. The proposal is based on the existing agreements and on the attitudes and opinions expressed via the questionairre. Where possible the views of the licensees have been catered to, having regard for the requirements of the licensor and the authorities at the same time.

By definition this is the first step in the itterative process of progressing the industrial agreement to perfection. No attempt is therefore made to suggest that the proposal is not subject to discussion and change, or that by adopting it that success will be guaranteed.

It should also be remembered that only the areas of principle are addressed and no attempt is made at proposing the legal and technical solutions which will vary from one situation to another.

4.3.1 General Provisions

4.3.1.1 Description of the parties

- Specific provision should be made to allow the franchisor access to financial, technical and historical information relevant to the service being franchised.
- Reciprocally provision should be made for the franchisee to discuss relevant information pertaining to the franchisor without recrimination.

4.3.1.2 Nature of the franchise

- The franchisee should be allowed to operate under his own established name but should be obliged to identify himself as a franchisee in specific ways.
- The period of the agreement should be stipulated. This should be a fairly short period of typically ± 5 years and the circumstances under which it is either renewable or cancellable by either party must be spelled out.

4.3.1.3 Territory

- The area of operation should be left to the franchisee's discretion.
- No attempt should be made to grant exclusivity unless this can be guaranteed.

4.3.1.4 Protection from Competition

- Compliance with technical specifications of the highest possible standard should be enforced.
- Inspection of work by third parties as well as the franchisors employees should be assured.

4.3.2 Start up Provisions

4.3.2.1 Deposit of fees

- A minimum capital investment should be stipulated to ensure stability of the franchisor.
- No attempt should be made to sell the franchise for a profit.
- Provision for the payment of fees for specific purposes other than the above must be set out.

4.3.2.2 Land, Buildings, Equipment and Facilities

- No attempt should be made to stipulate the premises from which the franchisor operates.
- Logos, colour schemes, etc., to which the franchisee must adhere as part of his being identified as a franchisee should be specified and phasing in periods set.

4.3.2.3 Training

- Product and technique training should be compulsory.
- Provision should be made for both initial and ongoing proof of competence by the franchisee.

4.3.3 Operating Provisions

4.3.3.1 Assistance in Purchasing

- Provision should be made for security of supply from the franchisor.
- There should be an incentive for the franchisee to use the product in question and remain loyal. Discounts and credit facilities are the most common.

4.3.3.2 Guidance in bookkeeping

- Standard information returns should be provided for. Only information relevant to the franchise should be demanded normally.
- There should be provision to obtain deeper information if default is imminent.
- Assistance in accounting procedures should be available on request only.

4.3.3.3 Manageme·t and Promotions

- Management assistance should be available on request.
- Provision must be made for circumstances in which this can be enforced.
- Advertising should be joint and from joint contributions. The method of using the contributions should be set out.

4.3.3.4 Recommendations on Sales

- The scope. and nature of what is permissable under the franchise should be specified. Also all technical references and procedures blueprints must be identified. Allowable instances where deviations may be permitted should be set down.
- No attempt should be made to fix prices for the franchised service.
- Conditions under which special deals or contract prices will be negotiated must be set out.

4.3.3.5 Performance by the franchisee

- Conditions governing sub-contracting should be set out. Generally sub-contracting should not be allowed.
- Minimum levels of activity may be set to obviate the problem of dormant franchisees.
- No attempt should be made to limit the size of the franchisees operation.

- Access should be guaranteed to all sites where the services are being conducted, for the purposes of inspection.

4.3.3.6 Reports and Royalties

- Provision should be made for the submission of activity reports on an ongoing basis by the franchisee as well as the content of these reports.
- Royalties should not be charged as such. Provision for payment for product and the percentages to be deducted for specific applications should be very clearly stated.

4.3.4 Termination

4.3.4.1 Renewal of terms

- Terms allowing termination of the agreement by one party only should be avoided.
- Circumstances under which a negotiated termination before the expiry date of the agreement can take place should be enumerated.

4.3.4.2 Transfer of Rights

- Cession and assignment of rights and obligations under the agreement should not be allowed.
- The parameters for re-evaluation and approval after such cession or assignment should be set if applicable.
- The consequences of breach should be specified.
- Changes in beneficial ownership of the franchisee company should constitute automatic termination.

- The reappraisal and reapproval of franchisees after such termination should be addressed.

4.3.4.3 Terminations for cause

- All actions or omissions which constitute material breach of the terms of the agreement should be explained.
- Restraints of trade should not normally be a consequence of breach of the agreement.

4.3.4.4 Terminations without cause

- The principle set in 4.3.4.1 should be followed.

4.3.4.5 Obligations on termination

- It is vitally important that the obligations of both parties on termination for whatever reason be clearly stated. These obligations will necessarily vary from one agreement to the next.

4.3.5 Conclusions

In general the current situation is that agreements in the industrial sector tend to be incomplete. Far to much is still left to chance and implication. The basic concept of putting it all in writing along with the above recommendations should go some way to improving the situation.

4.4 Further Research suggested by the study

Industrialised and innovative building materials and methods have been tinkered with by many large and small corporations for many years in South Africa. There has for various reasons, however, been little genuine progress to date. These reasons include being hamstrung by red tape and regulations, and the amount of time and money required to perfect technical aspects. Also because of the small scale of operations to date, economies of scale have not been achievable, and finished products have therefore not been price competitive with traditional methods.

Two areas requiring further research, as indicated by this study are therefore the following:

- Firstly there is the effect that the lifting of old regulations and the introduction of the new National Building Regulations will have on franchising or licensing as a concept in the industry. Will it grow or die out?
- Secondly there is the area of researching the usefulness of the franchising/licensing system to large corporations engaged in research and development programs in this sector. Can it be used as a means of funding research and achieving market penetration?

4.5 The future - Which way?

That National Building Regulations have opened up the way for the exploitation of new and innovative methods. They have also to a large degree done away with the classifications of "new" and "innovative", in that any product/system which achieves an Agrèment certificate is now no longer innovative, but traditional by definition. It seems therefore that the persuance of franchise systems within the industry, will in the future be the result of marketing strategy and not technical necessity as in the past.

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3. "Site Selection." The Infofranchise Newsletter, 7. No. 1:6, January 1983.

4. Pintel, G. and Diamond, J. Retailing; 3rd ed. (New Jersey, c. 1983). PP. 36 - 36.

5. Marquardt, R.A. et. al. Retail Management - Satisfaction of Consumer Needs; (Illinois, c. 1975). P. 93.

6. Mendelsohn, op. cit., P. 36.

APPENDIX A

LICENSE AGREEMENT QUESTIONNAIRE

DEFINITIONS

1. The licensor is person granting the license to use his product or service.

2. The licensee is the person who is licensed to use the grantors name, products services under certain conditions laid down in the agreement.

3. The parties means both the licensor and the licensee.

4. The licensed services means the product and the erection or installation thereof.

QUESTIONNAIRE

LICENSING AGREEMENT

A. General Information

1. Company Name:
2. Name of Respondent:
3. Position in the Company:
4. Nature of work done by the Company:
5. Number of Employees:
6. Annual Turnover:
7. Do you understand the implications of a license agreement? [Yes] [No]
8. Do you think such agreements are applicable in the building and construction industry?

   a. generally [Yes] [No]

   b. in your company [Yes] [No]

B. General Provisions

1. Before signing a licensing agreement is it fair that facts relating to the financial position and history of the licensee (including interests in other business)

   a) be demanded by the licensor. [ ]

   b) be disclosed only if they are relevant to the agreement. [ ]

   c) remain secret to the licensee. [ ]

QUESTIONNAIRE

LICENSING AGREEMENT

A. General Information

1. Company Name:
2. Name of Respondent:
3. Position in the Company:
4. Nature of work done by the Company:
5. Number of Employees:
6. Annual Turnover:

7. Do you understand the implications of a license agreement? Yes / No

8. Do you think such agreements are applicable in the building and construction industry?

    a. generally Yes / No

    b. in your company Yes / No

B. General Provisions

1. Before signing a licensing agreement is it fair that facts relating to the financial position and history of the licensee (including interests in other business)

    a) be demanded by the licensor. ☐

    b) be disclosed only if they are relevant to the agreement. ☐

    c) remain secret to the licensee. ☐

2. When operating under license should the licensee

   a) be obliged to operate under the licensors name and forego his own identity. ☐

   b) operate under his own name but be obliged to identify his business as one licensed to the licensor. ☐

   c) retain his original identity and have no tie back to the licensor. ☐

3. Should the period of the agreement be

   a) in perpetuity. ☐

   b) renewable/cancellable at the option of either party. ☐

   c) for a fixed period only. ☐

4. Should the area in which the licensee may offer his service be

   a) specified by the licensor. ☐

   b) negotiated by both parties. ☐

   c) not limited (i.e. the licensee may compete for business wherever he likes on an open market basis). ☐

5. Should a licensee be restricted to

   a) only carrying out the licensed services. ☐

   b) carrying on the licensed services as well as any other business agreed to by both parties. ☐

   c) not restricted at all. ☐

C. <u>Start up Provisions</u>

1. Given the nature of the building industry is it fair that the licensor should demand

   a) an up front fee for the use of his name, products, expertise etc. ☐

   b) a minimum capital investment by the licensee in his business to ensure stability. ☐

   c) no fee at all. ☐

2. Having signed the licensing agreement should the licensee with respect to his premises and vehicles

   a) be forced to use the stipulated colour schemes, logos etc of the licensor immediately. ☐

   b) be given time to phase in the above. ☐

   c) be allowed to continue operating using his own colours, logo etc. ☐

3. Should the premises from which a licensee operates be

   a) stipulated by the licensor. ☐

   b) decided on by negotiation. ☐

   c) left to the choice of the licensee. ☐

4. Should product and installation techniques training (both initial and ongoing), be

   a) compulsory at the insistance of the licensor for all licensees. ☐

   b) compulsory for new licensees only. ☐

   c) provided only at the request of the licensee. ☐

5. It is fair with regard to the maintenance of standards, that the licensee be required to provide proof of his competence in providing the licensed services

   a) both initially and on an ongoing basis. ☐

   b) initially only. ☐

   c) not at all. ☐

6. When the product or service being licensed is subject to third party controls, e.g. Agrèment Board certification, should these controls (standards) be

   a) enforced by the licensor in all cases ☐

   b) applied with discretion after negotiation between the parties. ☐

   c) not be strictly applied where the licensee has proven expertise in providing the licensed service. ☐

D. <u>Operating Provisions</u>

1. Given that the licensee has certain obligations under the agreement, should he in terms of purchasing, credit facilities and discounts

   a) be given preferential treatment at all times. ☐

   b) be given preferential treatment only on special contracts. ☐

   c) be treated the same as any other customer depending on purchase volume etc. ☐

2. Given that shortages may occur in the building industry should the licensee be

   a) obliged to purchase from the licensor only and e.g. be rationed if necessary. ☐

   b) given a list of "approved" suppliers. ☐

   c) allowed to select his own sources of supply. ☐

3. Should the licensee be obliged with respect to books of account and financial standing to

   a) deliver to the licensor all information demanded whether on prescribed forms or otherwise. ☐

   b) deliver only summary documents such as balance sheets for inspection. ☐

   c) maintain secrecy on all such matters. ☐

4. Should assistance with regard to administration and management of the licensees business

   a) be obligatory at the insistence of the licensor. ☐

   b) be imposed only in certain special cases. ☐

   c) be available at the request of the licensee only. ☐

5. Should advertising and promotion of the licensed service be conducted

   a) by the licensees only and at their own cost. ☐

   b) by both parties and from joint contributions. ☐

   c) by the licensor only at his own cost. ☐

6. Should the nature and scope of the work to be carried out under license be

   a) dictated by the licensor.

   b) negotiated on a contract for contract basis.

   c) left to the licensees discretion.

7. Should the selling price of the licensed services be

   a) dictated by the licensor.

   b) negotiated by the parties on a contract for contract basis.

   c) determined by the market.

8. Given that a license of this nature is generally granted for a service, i.e. product plus installation should the licensee

   a) be obliged to perform the total service himself.

   b) be allowed to engage sub-contractors.

   c) be allowed to sub-contract and sell the product on the open market as a distributor.

9. Should there, in the interest of control and maintenance of standards

   a) be a limit imposed on the size of the licensees operation.

   b) be limits imposed only in cases where the licensee has become unstable.

   c) be no controls imposed.

10. Given the nature of the industry is it reasonable for the licensor to stipulate

   a) minimum levels of activity.

   b) continued and uninterrupted provision of the services.

   c) minimum initial orders only.

11. Given the contractual nature of any licensed services, should the licensor or other third parties to the carrying out of the services (e.g. the Agrèment Board) be

    a) allowed unlimited access to sites where work is in progress or complete.

    b) allowed access only after requesting permission (which may be denied).

    c) allowed access only at the request of the licensee.

12. Should it be obligatory for activity reports regarding contracts to be undertaken in terms of the license agreement to be

    a) submitted before any contract is commenced for approval by the licensor.

    b) submitted on a periodic basis indicating contracts completed and forthcoming.

    c) submitted only on special request by the licensor.

13. Should the payment of ongoing royalties or fees in respect of the agreement be paid to the licensor

    a) as a matter of course as payment for the use of his name, product, goodwill etc.

    b) only in respect of specifically justifyable expenses such as advertising or the provision of management services.

    c) not under any circumstances.

E. <u>Termination Provisions</u>

1. Given that the agreement is for a fixed period should it be renewable.

    a) at the option of the licensor.

    b) by negotiation between the parties.

    c) at the option of the licensee.

2. Should the licensee be allowed to cede or assign any of its rights or obligations in terms of the agreement

   a) under no circumstances. ☐

   b) only with the licensors permission. ☐

   c) as and when he sees fit. ☐

3. Should the change of beneficial ownership or membership of the licensee company

   a) constitute automatic cancellation of the agreement. ☐

   b) be allowed subject to the approval of the licensor. ☐

   c) be allowed in all cases as it is the licensees business. ☐

4. Where an agreement is terminated because of a breach by the licensee, should restraint of trade agreements be allowed

   a) as a matter of course. ☐

   b) in special circumstances only. ☐

   c) under no circumstances as this is the licensees only method of earning a living. ☐

5. Should the agreement be cancellable

   a) at the option of the licensor. ☐

   b) by mutual agreement. ☐

   c) at the option of the licensee. ☐

6. On termination for whatever reason, should the licensee be obliged to

   a) return all signage, material etc and cease trading under his current name. ☐

   b) return all signage but be allowed to continue to trade under his own name. ☐

   c) be allowed to continue business as usual and forfeit only favourable discounts etc enjoyed as a licensee. ☐

F. Please make any general comments

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