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RESEARCH ARTICLE

Franchise Business Opportunity in Mexico

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ABSTRACT

The main objective is to review the growth that have taken the franchise in recent years in Mexico and answer the question; why this model is so successful franchise? Based on the theory of transaction costs and agency theory, the method used for this research is analytical. It can be concluded that the action of buying a franchise should be investigated carefully. Although legal protection is available, the best strategy for this model is that it covers many weaknesses in markets such as opportunism

INTRODUCTION

Mexico is a country that has all the resources to get access to a position within the group called BRIC, comprising Brazil, Russia, India and China, which have been designated this name because it could exceed the gross domestic product (GDP) of the economies. It is well known today that most of national economies are in a recession due to the mismanagement of its resources, which has helped other economies to faster development. Mexico currently has the resources to enter the fight for that place and achieve an international projection to drive growth in its economy and through a well-established strategy to position itself within other economies through a business model called franchising. Franchises are business models that have already achieved a level of knowledge in the world. Franchise happens to be a safe way for companies wanting to expand. Not all franchises can be applied in the same way in all countries but they can do some adaptations as did McDonald's in India with their veggie burgers. Franchising is the growth option in a country, whether the system of business expansion most used and developed in the modern economies, especially in certain sectors. It is important for positioning and prospects may have growth because of its profitability and the coverage can have on other markets. Franchises are currently known and recognized throughout the world, including Subway, Burger King, Helados Holanda, el Pollo Pepe, among others, but generally the best known are the food, but not for that the other items can be equally less striking. We are living in an era where technological advances, ideas, globalization and the desire to know more lead us to demand more, but the risks must be taken with calm and mostly with experience. A good option is the franchise, which give us the knowledge and a less risky manner we can move forward and grow. United States has used this model where retail has extensive stability and 95% of businesses that are established under this system survive while making a business on our own account we know that 1 in 10 or 15 companies will achieve good results and remain.

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Franchises in Mexico

Mexico is consolidating as a country of franchise investments for U.S., Spain, Brazil and Portugal because it is a key market for the franchise industry. At least 40% of the expansion projects are oriented to Mexico. Mexico currently has 1013 franchise concepts, a figure that places the country in seventh place in the world and second in Latin America, and has more than 65,000 outlets (FIAF, 2012). According to the Mexican Franchise Association (Asociación Mexicana de Franquicias, AMF) there are over 235 companies that achieved accreditation from the Ministry of Economy (SE) and that growth was allowing tripling the base last year. Regarding the development of new franchises, there are 452 companies that are in the process of becoming new networks, thanks to the support of the program (AMF, 2012).

Franchise system

In the franchise system, there is a franchisor and a franchisee. The franchisor is a natural or legal person that has a solvent company and commercial prestige, besides it should have a new concept of business or have any interesting or attractive feature to want to be franchised. The franchisee is a person or entity that pays to obtain the rights to market the products he purchased. Currently being given much publicity to franchising since in some cases, it has become a very successful model. The interest in investing in Mexico is due to the size of the consumer market and the experience that has been acquired. The costs of obtaining a franchise from the lowest investment ranging from $ 5,000 to $ 100,000 pesos and more investment can range from U.S. $ 301,000 to U.S. $ 600,000, which would be the cost of a franchise of McDonald's or Burger King with an initial amount of up a million dollars. First, it must focus on knowing how or have done well to be successful franchises and how they have sustained over the years, so we have to know what were the major theories and lines of research applied to franchises.

Theories on the franchise system

In the literature it is found that the development of the franchise is based on six theories, agency theory, and theory of transaction costs, theory of resource scarcity, theory of the extent of risk, contractual theory and theory of signals. Based on these theories, the focus is on the agency theory and the theory of transaction costs. Speaking of the theories more used to explain the franchise with a focus on business strategy, it is not possible to skip the theory of transaction costs, which, together with the agency theory, dominate the literature of franchises (Burton, Cross & Rhodes, 2000).

Agency theory

The agency theory (Jensen and Meckling, 1976) is the most commonly used to explain the relationship between the franchisor and the franchisee, and also the establishment and development of the contracts governing the relationship. In franchising there are a franchisor (principal) and a franchisee (agent) which maintain a working relationship where the owner is the franchisor who has objectives such as expanding the business and the franchisee takes responsibility and work to perform some tasks to create a company combining his skills and abilities to achieve common goals. Although agency theory assumes that the agent may be tempted to hide information about his or her real primary qualities, as the franchisee should be aware of the hard work, commitment to work and enjoy working with other people, be good supervisor and organized to perform the work assigned (Jensen and Meckling, 1976). In this case for the agent, opportunism is diminished because this capital invested to acquire knowledge or recognition of the company at stake, what means that the agent will act rationally for his or her own interests. In a franchise, the franchisee could not act opportunistically against the interests of the franchisor as it is the owner of the establishment for which he has made significant capital investments, time and work. Thus, it is assumed that there is great interest in the franchisee that the business runs well (Brickley and Dark, 1987).

Transaction costs theory

Transaction costs are the costs that companies incur when, instead of using their own internal resources, they go to market to find these products, services and rules set out in a contract. Companies seek to minimize those costs as much as possible, although it is known that this is only possible in a competitive market. The origins of the transaction cost theory (TCT) goes back to the theoretical framework initiated by Coase (1937, 1960, 1994) and continued by Williamson (1975, 1981, 1991), in which firms are seen as efficient agents (Chang and Rosenzweig, 2001), they outsource activities to external agents who are ready to perform at a lower cost than if it had been done the same company. When the company decides to enter a market is at risk of being affected by opportunism and wants to take advantage of the limited rationality of agents and uncertainty, where each individual takes risks. Such actions lead companies to generate costs for the enforcing contracts that somehow guarantee security because there will be a regulatory body to protect these interests and the above costs are high opportunism. Other activities that further raise transaction costs are searching for information on pricing, product quality, labor, finding buyers, sellers, knowledge of the real situation, purchasing power and sourcing, contract formulation and subsequent monitoring to ensure compliance of the same part of the agents involved. The franchise model allows minimizing the costs and risks compared to investing in a business in the transfer of goods and / or services, where it is spoken of imperfect information and the parties have made investments, each of which promotes its own interests at the expense of others, using a behavior that leads to opportunism (Jones, 1987:1999).

From all the above mentioned, the franchise system is a widely studied model by its franchisor, increasingly refined and adapted to new trends. It was created in Mexico the Mexican Franchise Association (MFA) (Asociación Mexicana de Franquicias, AMF) in 1989 with the purpose of helping the economic development of Mexico and following the laws, rules and support for the acquisition of franchises and business. Mexican Quality Certified (Calidad Mexicana Certificada, Calmecac) have created the so-called "Seal of Quality", whose main objective is to arrange the market and boost the activity between the franchisor and franchisee by helping them to have more credibility and trust when making investments. Franchises in Mexico are based on two articles: 142 Industrial Property Act and 65 of its Regulation (IMPI, 2012). The legal framework of franchises is constituted by the Constitution of the Mexican Republic, Articles 25 and 28 of the Commercial Code, the Federal Civil Code, Copyright Law, Consumer Protection Law, Competition Law, Law of Commercial Companies, Industrial Property Law and Competition Law. Williamson (1991) introduces an additional aspect in the discussion of the theory of transaction costs, combining the criterion of efficiency as a fundamental aspect which measures the performance of the company, in order to save costs. Mexican law requires franchisors delivering a Franchise Offering Circular (COF) to be surrendered by either domestic or foreign to those who wish to acquire a franchise A view of a franchise as a unit business for sale of another is a very well established network with others and these in turn to other organisms that cause minimal opportunism. So it must be studied the company as an economic organization that presents problems associated with transaction costs, generation of transaction costs besides the "Know How" which basically is the secret of success of it. Here it is discussed bounded rationality; together with the opportunism which are two assumptions made by Williamson (1981) on the behavior of economic agents. The assumption of bounded rationality means that economic agents try to maximize their profits but do not always succeed and thus enters the opportunism that is to benefit oneself.

Knowledge (know-how)

Is the delivery or transfer of business knowledge, is to know the formula for success of each franchise in particular. It is formed by the experience and technical capabilities that are on a specific activity of a specific market. This knowledge is captured in a "Manual of Operations and Procedures" that the franchisor gives the franchisee, along with education and training on all aspects of the business, when the franchise is purchased. The franchisee must perform activities as described in the manual, acquiring the "know how" carries a cost and another if is not met as stipulated, it could even affect the franchisor. This manual contains information in the fields of administration, finance, marketing, human resources, control, and production and is designed to be the verbatim. In Mexico there is an association that protects the rights of the franchisor's intellectual property against piracy through the work that has been developing the Mexican Institute of Industrial Property (IMPI), dependency created by the Ministry of Commerce and Finance (Secretaría de Comercio y Finanzas, Secofi) for the registration and protection of all matters relating to industrial protection, trademark, and patent rights in charge to regulate permits and licenses of brand, but as it has seen is difficult to control so it is important to have a well-established core competence and a good strategy. A foreign franchise may be easier to enter another country through the franchise system existing in the country and adapting quickly (International Franchise Association).
The theory of transaction costs and agency theory are basically developed by Williamson (1975, 1985) and Coase (1937). It is important to mention that more studies have been done on the allocation of theory of transaction costs in multilevel companies and hybrid business organizations helping to understand how companies make their entries into new international markets.

Problem statement and research question

The creation of franchises as a business in Mexico has been growing in recent years. According to figures from the AMF, from the 1013 estimated franchises in the country, about 500 are really active, and nearly half of the operating are already accredited in the PNF. According to the AMF, the turnover of this sector in Mexico is about 85 billion dollars annually and directly employs more than 500,000 people. According to these data, the sector continued the trend of previous years, growing 13% in 2011. To achieve this potential franchise to materialize, it is necessary to boost the sector through specific support clearly aimed at the use of these successful models (AMF). So it is important to know what good the franchises are doing to be successful and have achieved growth.

Objective of study

The aim of this paper is to analyze the franchise model in general terms to know about the growth and expansion that have franchises in our country in recent years.

Methodology

The methodology used is the analytical of information obtained from the literature review regarding the theory of transaction costs and agency theory. It also is analyzed the information provided by the Mexican Franchise Association, the Canadian Intellectual Property Institute Industrial, American Federation of Franchising (FIAF, 2012) and the World Franchise Council (WFC, 2012).

Conclusions

Franchising is a business expansion mechanism that has been very successful not only in Mexico but throughout the world. It is a time that franchises have achieved worldwide recognition and have created food habits and customs specially affecting consumers. This model helps to minimize transaction costs and reduce the risks of investing in a business. The implementation of this business model has created the need for agencies "regulatory" to help and guide both parties' franchisor and franchisee. Not all franchises that exist in Mexico are national and in fact, the most successful franchises are foreign but also those with a high transaction cost.

What would these advantages of buying a franchise.

- Rapid expansion.
- The recognition of a recognized brand allows better access to the market, avoiding risks and costs of marketing and product positioning.
- The brand benefits from increased market presence.
- Having access to strategic locations for marketing the product. Having a "backup" recognizable to negotiate better and take advantage over the competition.
- Maintain control of the business, but with certain limitations (Generally the costs of operating business units are superior to a franchise).
- The existence of economies of scale with respect to marketing, purchasing and operations.
- Advertising campaigns are optimized, you get better prices for volume purchased, cost sharing research and development, etc.
- You can have statistical information about the market in which the franchisee works to analyze growth, investment and future development.
- The risk when you have a franchise, rather than a network, is lower in case of financial problems.

Disadvantages of franchising for the franchise

- Less flexibility in business operations as it has franchisees that must negotiate to implement certain changes
- Must meet contract terms.
- Mismanagement of other franchisees may harm the image of the brand, and
  therefore the business of self.
- The possibility of negative actions by the franchisee that could damage the image of
  business, regardless of contractual clarifications.
- The possibility to assume serious legal problems, and which is original responsible for the quality of a product or service.
- The loss of control over the business. This can occur with rapid expansion of the
  franchised network and poor layout in the organization of the franchise.
- The franchisor loses a potential share of the profits, which is used by the franchisee. That is, there is a lower gross profit margin.

The information available as to the success of a franchise is not reliable because many people believe that buying a franchise is going to ensure financial success. But there is also the sad side where buying a franchise has led to financial ruin. Buying a franchise should be investigated carefully. We must not only think of the advantages of buying a franchise, but should think about creating a model that can be used and franchisee.

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