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## FRANCHISING MODEL AT AGRICULTURAL ENTERPRISES. MARKET OVERVIEW, PERSPECTIVE, APPLICATIONS

Administrating of agricultural enterprise nowadays presumes application of the latest technological developments and modern management methods which meets the requirements of market competition. Market changes in different aspects are specified as follows: technological innovations, consumer's preferences, logistics, quality requirements and financial instruments. Still, the transformation of management model of the companies and farms continues. These changes affect many factors that occur in political life and public order of European countries, as well as worldwide.

The period of global redistribution of natural resources and political models leads to the changes in economic sphere and also requires flexible approach to the establishing of management models that will compete and attract investments into the industry. Franchising and its application at farms already found its supporters, but at the same time it is quite a new phenomenon for the industry in Europe. Unlike other industries that have used franchising for over 30 years and have sufficient experience of successes and failures, franchising in agriculture only started building of it's own successful model and it takes a time and efforts to set up a successful model. In Ukraine franchising covers broad segment of economy, but in many other areas and sectors of the economy, in particular, in agriculture, it has to be promoted and developed.

The purpose of this work is to demonstrate and emphasize the importance of franchising model promotion in agriculture area as one of the effective methods of industry development and attraction of investments. Our previous researches and work done regarding franchising effect on entrepreneurship improvement in agriculture served as a basis for this study and following research on franchising in agriculture.

**Key words:** *franchising development, agricultural franchising, franchising model, farm franchising*

**Introduction.** Transformation of management model of agricultural in Ukraine is going through a difficult period of restructuring and transition economy from "Soviet period" to building of the model of modern European standards. Simultaneously, a number of complex processes, such as: the rejection of "planned Soviet economy", the formation of entrepreneurship spirit among farmers, ongoing transformation of the political system of the state and the power struggle between oligarchic clans, which greatly influence the formation of the economy sector, as well as the pressure of external factors. Today Ukrainian farmer has a clear intention to adopt European standards, and thanks to the external political environment, changes occur in government standards of Ukraine.

For forming of policy management in agriculture the European Union provides us main guidelines laid down in the Common Agricultural Policy of the European Union (CAP)<sup>1</sup>. The key objective of this policy is clear and simple: to provide the population with food in sufficient quantity and this process must be continuous and self-sufficient. Of course, from the beginning of this policy there have been several reforms and changes. But the key aspects, in addition – the CAP provides and improve the quality of life of residents of rural areas, an increase in wages to employees of the industry, increased productivity of agricultural production and preservation of the availability of the prices of agricultural products for consumers.

<sup>1</sup> European Commission. Common Agricultural Policy of the European Union. <[https://ec.europa.eu/agriculture/cap-overview\\_en](https://ec.europa.eu/agriculture/cap-overview_en)>.

**Method and Materials.** The latest analytical data used on franchising in Ukraine, and the European Union became the background of our research. Studying and grouping of world markets was traditionally prepared by the International Franchise Association<sup>1</sup> and International Trade Administration<sup>2</sup>. On the basis of data of the Franchising Federation of Ukraine<sup>3</sup>, Europe Franchise Federation<sup>4</sup> and IFA<sup>5</sup>, we were able to generate major trends in agriculture through the franchising model, which will be developed in Ukraine. Many scientists over a long period have studied the franchising model, which essentially facilitated our research, as their experience and knowledge are ready to present us some "recipes" for success using of the franchising model in other industries. Among them, G. Mellinger<sup>6</sup>, J.M. Mulet<sup>7</sup>, M. Stankovich<sup>8</sup> and others. Trends in the manufacturing of environmentally friendly products and consumer's deny from the genetically modified food encourage entrepreneurs to search for successful business models in this area and for the rapid development of their farms.

**Results, Discussion, Conclusions.** All these demands of modern market and consumers evoked formation of such a model of development and management at agricultural enterprises, which provides for high efficiency, low risk of initial phase of development, rapid return of investment, and sustainable development. Therefore, we believe that the franchising model can reach the goals set by CAP for agriculture area. The concept of franchising model research in agriculture – this is our contribution to achieving of goals stipulated by CAP and to increased integration of Ukrainian farmers to the European standards declared in the CAP.

Our previous research of agricultural franchising was built on specific concepts, such as:

- Franchising Model<sup>9</sup> – an important element of the trade mark (brand) of the company. Franchising was considered as the most effective way to achieve maximum coverage of development areas and increase of customer loyalty.

- Model of franchising as a method of effective attraction of investments in the sector<sup>10</sup> and economy in times of crisis.

- Analysis of franchising market of Ukraine<sup>11</sup>, description of all key areas, description of franchise structuring markets drawbacks and its advantages in the development of various industries.

- A number of conclusions on market trends and recommendations for further research were made.

Today in Ukraine franchising model is used by more than 405 companies, but only two of them belong to the agricultural sector<sup>12</sup>. The choice of governance forms and development of the farm is influenced by several important factors, including:

- Registration and ease of doing business.
- Continuity of the business regardless changing of activities within the enterprise, development or reorganization.

- Transfer of business and assets.

- Taxation consequences directly related to the form of organization.

- Responsibility of the owner.

- The possibility of acquisitions and expansion capital, the possibility of its sale.

Taking into account that farming is mainly a family business where key role in decisions making belongs to the head of the family, it means his knowledge and experience influence the choice of method and form of governance. That circumstance of business existence which does not consider changes in activities within the enterprise, development or reorganization and the need for expansion of capital and

<sup>1</sup> Hasham, A. (2016). *Communicating the Positive Message of Franchising*, IFA Convention, February 2016.

<sup>2</sup> International Trade Administration. 2016. *2016 Top Markets Report Franchising*. <<http://www.trade.gov/topmarkets/>>.

<sup>3</sup> *Franchising Federation of Ukraine*. <<http://www.fdf.org.ua/>>.

<sup>4</sup> EFF, Europe Franchise Federation. 2012. *EFF Franchise Report*. <<http://www.eff-franchise.com/Data/PUBLICATION%202012%20EFF%20FRANCHISE%20REPORT.pdf>>.

<sup>5</sup> Hasham, A. (2016). *Communicating the Positive Message of Franchising*, IFA Convention, February 2016.

<sup>6</sup> Mellinger, G. (2010). *La Franchise: La stratégie. L'opérationnel*.

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<sup>8</sup> OECD (2011). *Evaluation of Agricultural Policy Reforms in the European Union*, OECD Publishing

<sup>9</sup> Mellinger, G. (2010). *La Franchise: La stratégie. L'opérationnel*.

<sup>10</sup> International Trade Administration. 2016. *2016 Top Markets Report Franchising*. <<http://www.trade.gov/topmarkets/>>.

<sup>11</sup> Чикуркова, А., Ногачевський, О. (2016). Франчайзинг: актуальні проблеми розвитку в Україні. *Збірник наукових праць Подільського державного аграрно-технічного університету*, 348, 1-16.

<sup>12</sup> Чикуркова, А., Ногачевський, О. (2016). Франчайзинг: актуальні проблеми розвитку в Україні. *Збірник наукових праць Подільського державного аграрно-технічного університету*, 348, 1-16.

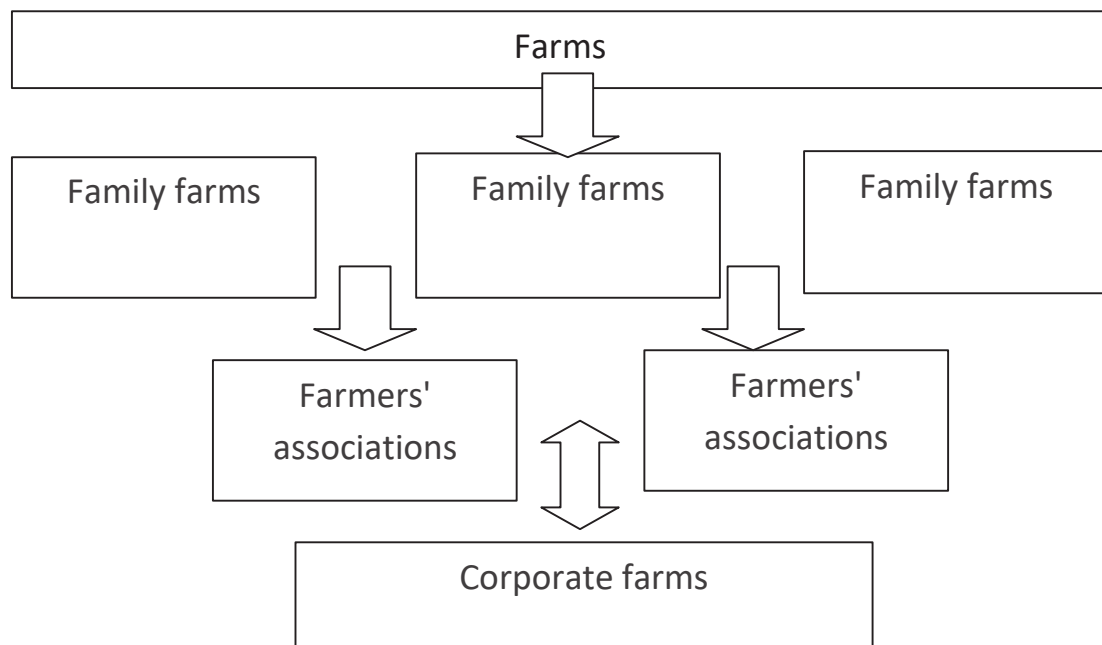
attraction of investors may compel the farmer to explore opportunities offered by the business model of franchising. The majority of farmers in Ukraine have basic knowledge on production technologies, processing and storage of food, which they produce. Educational institutions, academic sector and other information source propose modern technology, hardware, and more. The information on which steps the farmer has to undertake to transform fast thier profile inside the industry and how to get investments from the financial market, except for banking, is absent.

Number of market participants of OSG (farmers) currently amount to more than 4.5 million<sup>1</sup>. Farms in Ukraine exist in the following forms:

- Family Farm:
  - with the creation of a legal entity;
  - without legal entity;
  - collective farm.
- Also farms can unite in:
  - cooperatives;
  - company;
  - Union;
  - corporate farms in the form of joint stock companies;
  - state farms<sup>2</sup>.

Franchise model allows farms to diversify their business efficiently and grow their business through investment of partners – franchisees, using existing market knowledge and technology, technical support. However, at the same time diversifying of their own farm by developing several activities will cause further necessity to develop additional skills and organize themselves in associations or cooperatives which could be created on the basis of a certain activity or territorial type.

Which can be a number of steps for creating a franchise model of agricultural enterprises? A variety of organizational forms in agriculture do not allow to apply the franchising model in the industry simultaneously and widely, fig. 1.



**Fig. 1. Development of organizational forms in agriculture \***

\* Source: systematized by authors

<sup>1</sup> Беззуб, І. *Перспективи розвитку сімейних господарств в Україні*. Центр досліджень соціальних комунікацій. <<http://nbuviap.gov.ua/>>.

<sup>2</sup> Беззуб, І. *Перспективи розвитку сімейних господарств в Україні*. Центр досліджень соціальних комунікацій. <<http://nbuviap.gov.ua/>>.

Some farms are not always able to provide the complete support to its partners – the franchisee as required by international standards has to invent a model of franchise. Before the introduction of the franchising model, we must consider SWOT analysis of family farms:

### 1. Strengths family farms.

1. One of the key advantages – is work. The presence of "unpaid" work family is crucial in forming of individual farms of family type. The ability to influence family work seasonally and independently from fluctuations of the environment, that can not afford another non-family company type. Family work does not require institutional superstructure to monitor and control costs and check the reputation of the employee and the development of his loyalty. Operating expenses in the family farm grows along with farms incomes seasonally. Skills are passed not only by the academic education, but also by features of manufactured specific product or service in particular area.

2. Land as a key factor in agricultural production. In most Western European countries the share of private ownership of land is large enough. Ukraine is not an exception – family farms are based on a relatively small piece of land which is under the rent.

3. Manage of the own capital. Unlike businesses and corporate farms are not in a family-style, family farms can dispose more flexibly their own profits appeared as a result of the family "unpaid labor". Not only this profit may be used at separation of family members, but also as investment in the expansion and development of its economy. This gives for family farm significant advantages over other forms of farming. Flexibility of family farms in decision-making and use of technology is another benefit in the management of equity holdings of another company type. Family farm uses the machines and equipment quite long, and in unfavorable financial conditions provide for more flexibility to decide and consequently it increases their survivability on the market. Therefore, internal capital resources of family farming are not measured by their market price and suitable to control it better.

### 2. Disadvantages of the family farms.

- Exposure to external risks and political-administrative factors and social factors as compared with corporate farms and non-family businesses;

- Labor. The employment of the family can have a negative circumstance that the technological development and technological change increase the necessity for skilled workers, which are often not from the family. High-tech innovations lead to reduce of labor use, while costs for qualified specialists who are able to maintain this equipment are raised.

- Lack of "economies of scale" and land constraints. Failure in a certain areas of growth leads to loss of competitiveness in comparison to corporate agriculture. The technological innovations which can be afforded by a large-scale agricultural production are mainly inaccessible to the family farmer. This is one reason that in the future will lead to a sharp decrease of family farms number and raise proportions of those who will remain at the market. Changes in legislation on the sale of land will only encourage this. But international experience shows that the changes that have occurred due to "economies of scale" are less effective compared to the changes that can happen through optimal and efficient household use of family labor and gain of performance time by those innovations which already exist .

- Access to capital markets. To survive in highly competitive markets farmer is forced to continuously improve production technology and follow the changes which assist more productive and efficient use of limited resources. The changes require substantial investment that can provide investment institutions, if we talk about the market of cheap non-bank capital. Access to these institutions is very limited in the Ukrainian farmer or even absent. Especially in this period of high risks and economic crisis, there is no access to, though expensive, bank funds.

### 3. Opportunities.

- The ability to avoid significant tax burden. Uncertainty and imperfect legislation allows for flexibility in the tax burden. Certain benefits provided by the law for the development of new agricultural farming allows farmers to "stand up" and decide on directions and benefits of the activity.

- Flexibility in responding to changes of consumer needs. Direct contact with its customers helps to predict and respond quickly to future fluctuations in consumer preferences and of needs. Competent approach to decision making allows you to capture in a short period markets and maintain them.

- Due to the increasing demand for organic food, family farms capable to implement "green" technologies (solar, wind, biomass) by little cost and to offer market their products more expensive than the market price as opposed to corporate farms. The constant costs almost remain unchanged.

### 4. Threats.

- A key threat to family farming today – is a legislative and market uncertainty in Ukraine in the near and far future. Ukraine has one of the highest rates of corruption in the world.

• The lack of rural development and the local community as a place of "quality and comfortable" accommodation creates an outflow of young families who want to continue his father's work. In recent years Ukraine has seen a large migration of young people from the village and the country.

The research and analysis shows that building organizational units of family farming is possible even under conditions of high uncertainty and risk. If there are minor changes in the law and understanding of the importance of family farms, it can be developed, scaled flexibly change as business unit as through forms of cooperation and franchise models.

Based on data analysis, we can conclude that family farms have to be combined in various forms of association.

Our previous studies have shown that the main principles of the established and developing agricultural groups based on franchising and cooperation, include:

- combines one category of products or groups of products;
- sustainable range of products;
- TM and other intellectual property is common;
- entrance control and requirements for quality and composition of the finished product, which is mandatory for all suppliers and farms;
- principles and provisions for the selection and examination of farms as suppliers of goods and services that meet the international criteria and standards.
- unified pricing policy on the domestic market;
- unified marketing policy.
- rent or leased warehouse space for storage of agricultural products.

The concentration of these types of associations will force farmers to transfer certain functions of decision making to the governing body of the association. Of course, that lack of knowledge and skills of business management and development of enterprises, can lead to conflicts and decline of enterprises. Therefore the construction of curricula of development farm, their possible transformation to the association, using the model of franchising to expand their business and attracting investment requires specialists and time.

Application of franchising models at their development was the success factor, which allowed the market leaders to achieve economic prosperity and high capitalization. The key principles of creating franchising models include the following steps:

1. Creating a concept of franchise model.
2. Five business-lines of franchise development.
3. Financial aspects of the franchising.
4. Developing a model of management and engineering of franchising network.
5. Creating models of obligatory tools of the franchise development:
  - a. franchise operation manual;
  - b. creating "Operations Portal";
  - c. staff training and the creation of uniform service standards
  - d. monitoring compliance with common standards;
  - e. creating a contractual framework.

It is clear that the implementation and development of this model, farmers' associations should engage experts and specialists in different areas and skills. Additional features that will appear in the organization, will include the following areas:

- Franchise Sales and Development of franchising company;
- Management of franchisees network;
- Marketing Management franchise network;
- Financial management and accounting;
- Staff training to franchisees;
- Jurisprudence;
- IT – portal network.

International experience shows that when creating a franchise model and its development, these functions should be identified and form a separate business unit or a separate business organization. The sequence of the franchise model of agricultural enterprises development practically will not differ significantly from the commonly known principle, Fig. 2.

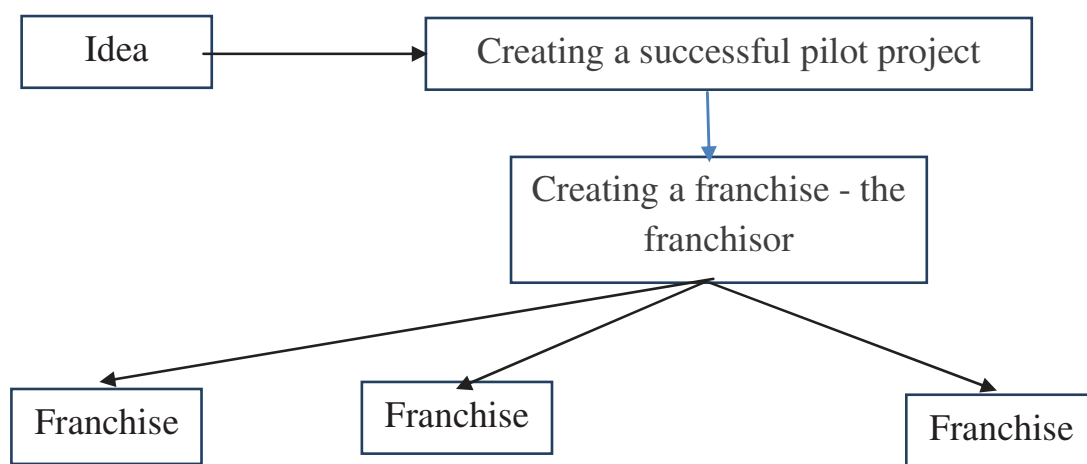


Fig. 2. Creating a franchise for agricultural enterprises \*

\* Source: systematized by authors

Which means that transformation will take place not only in the corporate governance model agricultural union, but it is necessary to develop new features and controls that had not been characterized for agricultural enterprises. Without sufficient methodological framework, without proven successful pilot projects and the use of international experience, such projects are bound to fail. Perhaps today it is only reason why absent widespread use franchise model in agriculture Ukraine.

Successful used franchise model in several agricultural producers requires thorough study, especially of their negative experience. Not always companies are willing to publicly share their negative experience, as this is not a sustainable practice in Ukraine and these companies are still in the stage of active development and attract both foreign investors and domestic – franchisees. But international practice already has 50 years of experience in franchise development and this allows us to explore the positive side use franchising and negative effects of the franchise<sup>1</sup> Understand the main reasons for that were precondition of such failures. Studying the international experience of franchising community, we have articulated the following main reasons for failure. In our opinion, they characterize in better way the activities of organizations not depending on the areas of:

- **Lack of business skills.** Possession of skills in agricultural production, the ability to sell and provide logistics – does not mean that the organization and its successful sales professionals have skills and development of franchising. Most successful companies lose control over the franchisee network development and for business in general it happens due to the following reason: lack of skills, and deny to search for this knowledge at market experts. Often franchisees begin their own search for the necessary information and acquire necessary skills without help and support of franchise owners, but in this case they are not corporate naturely and appeared haphazardly. All further attempts of franchisors "catch up" their partners do not lead to the desired result.

- **Franchisee underestimate its obligations.** Franchise owners and their brokers are often consciously in their messages to the market "lose" information which partners – the franchisee invest in buying and starting of a business, the franchise will have to work sometimes even more than before. Therefore, the franchisees often expect "miracles" – that someone will come and do them a business. When expectations are not fulfilled, the franchisee all blames for the failure try are switched to the franchisor.

- **Incompetence and lack of knowledge among staff.** Incompetence of staff tarts when training of specialists are neglected and random persons are appointed to the position of franchise. This is applicable also to the franchisor and in franchisee. But from the failure of the first suffers franchisees.

- **Location chosen by mistake.** The speed of the franchise can't bring money without improvement. Being not designed and not calculated new point of sales leads to significant losses. The bigger lose falls on the franchisor: reputation, income, bankruptcy. This mainly occurs in growing markets where franchise owners are blinded by increasing revenue from new partners and not interested in the profitability of each new point of sales performance of each manager and the new unit.

<sup>1</sup> Wilson, S. TOP 10 Reasons Why Franchising Fail. <<http://allbusiness.com/>>.

• **Lack of control over expenditure.** The main costs are related with small business hire. Rent practically can "eat" all your profits. Only large companies with proven financial perfect model business can afford high rents. But these are market units.

• **The lack of working capital.** Business achievement of breakeven requires money circulation. Access to funds of small business in Ukraine is expensive and limited. Often the franchisor, modeling the development of its business in franchise model, forgets to make a "buffer" which will provide work in future own company and franchisee.

• **The lack of pragmatic informed decisions.** Very often, when new partners deciding to purchase the franchise, guided by emotions and pleasant memories about the product or service. Using emotions partner, the franchisor does not try to find out additional information that would help both sides to take intelligent decisions.

• **Inflated claims payments to partners – franchisees.** The financial model of franchising provides a detailed calculation of all payments which will carry out franchisee to the franchisor. It is considered necessary by the fact that along with the franchisee other businesses can operate which has such obligations and other expenses which incurred the franchisees. Therefore, products and services of the other entrepreneur can be much cheaper at identical quality.

• **Franchisor does not provide adequate support.** Most franchise owners – are successful entrepreneurs who have established their business. By opening franchise without providing adequate support to its partners, franchisor practically reduces the success of its evolution to "zero".

• **The concept of creating a franchise system not properly.** Some franchise initially doomed to failure. Remember that franchise – is a well established system of business processes and procedures.

The concentration of these types of associations will force farmers to transfer certain functions of decision making to the governing body of the association. Of course, the lack of knowledge and skills of business management and development of enterprises, can lead to conflicts and decline of enterprises. Therefore the construction of curricula of farms growth, their possible transformation to the association, using the model of franchising to expand their business and attracting of investment requires specialists and time.

Promoting existing businesses developed on the basis of the model franchise in agriculture – a task which can only assume the Ministry and other state institutions. Information about the market opportunities provided by the franchise systems – is quite expensive process that cannot afford either the enterprise or specialized NGO's or individual schools and researchers.

Our research on implementation of franchising model at agricultural companies is also new for the European Union markets. There are only a few researches and work in different EU countries. These studies are united by one purpose – to achieve the goals that put the CAP in the most effective manner and with maximum benefit for all market participants.

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