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FRANCHISING GROWS IN A TIGHT ECONOMY

When the Franchise Association of South Africa (FASA), together with sponsor Sanlam commissioned Research IQ in 2014 to conduct a survey of the industry and track its growth, South Africa and the world had already been in a recession for five years. Despite trying socio-economic conditions, political uncertainty and tough trading conditions, the franchise sector has held its own over the past four years growing its contribution to the country GDP from 9.7% in 2014 to its present figure of 13,3% and its estimated turnover from R465 billion in 2014 to R587 billion in 2017.

"As a sector, we are doing great things in a tight economy" says Tony Da Fonseca, FASA's Chairman. "Tracking our success and looking for areas that need improving is part of the entrepreneurial nature that sets us apart as franchisors and franchisees. This is borne out by the fact that 78% of the franchisors surveyed are optimistic about future growth in their businesses, although it dropped significantly in the last year from 92% - a signal that the country's economic woes are affecting even the most resilient of business people. There is a concomitant increase in the number of franchisors and franchisees that are uncertain about the future, as well as those who believe their turnovers will not change. This is linked to a new franchisee taking longer than previously suggested to break even."

"Whilst we celebrate our tenacity in staying the course, with an increase in the number of franchised systems to 845, adding much needed small businesses (40 528 franchisees) and employing 343 319 people in our sector, we must be cognisant of subtle undercurrents of uncertainty that the survey has exposed which need to be addressed to make the industry even stronger."

"As an industry association and given the higher risks in starting a business in such a tight economy," says Da Fonseca, "we also have to protect prospective franchisee investors from unethical operators and caution them to do thorough investigations into the franchise companies they are considering buying into – and above all make sure that they are members of FASA which offers a certain measure of peace-of-mind given the strict scrutiny franchisors voluntarily submit themselves to."

With two in three franchisors claiming to have been in business for more than ten years and a further 17% for between 6 and 10 years, the longevity of these businesses supports the success of franchising and supports the mitigation of risk when buying into a franchise. Sanlam, the sponsor of the FASA Franchise Surveys also tracks the continuity and planning provisions that franchisors and franchisees make as part of their business strategy. "It is interesting to note," says Kobus Engelbrecht, Marketing Head: Sanlam Business Market, "that the majority of franchise owners (95%) claim to have an investment portfolio largely comprising retirement annuities and property but a bit concerning that the number of franchise owners claiming to have some form of continuity planning has declined in the past three years. However, confidence in their business choice and the immediate future is reflected in the fact that selling their franchise within the next 12 months is not on the cards for 97% of franchise owners."

"Despite a floundering economy, the franchising industry continues to make a healthy contribution to the South African GDP, a fact that is often overlooked by both the public and private sector," concludes Vera Valasis, FASA's Executive Director. "Benchmarking where we stand on the world franchise stage puts South Africa 36th in a list of 181 countries – between Singapore, Malaysia, Ireland and Pakistan in 34th, 35th, 37th and 38th place respectively – a position we can be greatly proud of."

HIGHLIGHTS OF THE FRANCHISE SURVEY

- At an average exchange rate for 2016 of R14, 68 to the dollar (US), South Africa's GDP for 2016 was R4 328, 25 billion Rand. This places South Africa 36th in a list of 181 countries, in between Singapore, Malaysia, Ireland and Pakistan in 34th, 35th, 37th and 38th place respectively.

- The estimated turnover for the franchise market is R587 billion Rand, which is 13,3% of the South African GDP.

- The highest proportion of turnover generated is by the Fast Food and Restaurants sector (29%), which is not surprising given that it is the largest sector. Three sectors share a further 43% of the estimated turnover in similar proportions – Building, Office and Home Services, Retailing and Business-to-Business Services.

- Ownership by Previously Disadvantaged Individuals for 2017 was given at 17%, similar to the 18% mentioned for 2016. There appears to be a slight downward trend in terms of PDI ownership since the 2015 survey, which may be as a result of the changes to the BBBEE Act of 2013. Categories such as Childcare, Education and Training, Personal services, Fast Foods and Restaurants and Building, office and Home services are above average in this regard. Approximately half the sample (56%) did not have any PDI ownership in their businesses at all.

- The employee count was pegged at 343 319, with the Retailing sector being the biggest employer. Sixty-five percent of employees are black, 24% white, 6% coloured and 5% Indian. The number of black employees has increased by 8%.

- In total, some 20 000 people are employed by franchisors, while 323 592 are employed by franchisees. These figures include both management and staff.

- When it comes to business ownership by women, the average percentage ownership is 25%. The sectors with the highest incidence of female ownership are the Health, Beauty and Body Culture and the Childcare, Education and Training sectors.

- Most franchisors (78%) are optimistic about future growth in their businesses. Although this is a positive figure, it has dropped significantly in the last year from 92%. There is a concomitant increase in the number of franchisors who are uncertain about the future, as well as those who believe their turnovers will not change.

- The number of franchisors who believe that it takes more than a year for a new franchisee to break even has increased markedly from 26% to 40%. A year ago, 73% of franchisors estimated that it would take less than a year for a new business to break even.

- South Africa has over 845 franchised systems, as per the FASA website. According to the findings of this study, there are 40 528 stores, 85% of which are owned by franchisees, compared with 95% a year ago. There is an apparent move towards company-owned stores and joint ventures (15% from 5% a year ago).

- In 2017, 71% of the franchisors interviewed claimed that they had opened a total of 2,789 businesses, 25% of which were fast foods and restaurants and 26% of which were in retailing; 16% were in the Health, Body and Beauty Culture sector. An estimated 105 businesses were closed down, resulting in a nett gain of 2,184 stores, 26% of which were each in fast foods and restaurants and retailing and 19% in the Health, Body and Beauty Culture sector.

- Thirty-one percent of the franchisors interviewed claimed to have stores outside of South Africa. Most of these stores are to be found in the neighbouring countries of Namibia and Botswana. Proximity to neighbouring countries, in comparison to countries further afield in East or West Africa, make them more popular choices for expanding outside of South Africa.

- A relatively small proportion of franchisors (one in eight) claimed to be represented outside of Africa.

- According to the FASA website, the largest franchise system is the Fast Foods and Restaurant category (25%). The Retail sector at 15% is the next biggest, followed by the Building, Office, and Home Services sector at 13%. Similar in size are Childcare, Education and Training and Automotive

Products and Services (9% each), and Health, Beauty and Body Culture at 8%. The other categories are 5% and smaller.

- Two in three franchisors claim to have been in business for more than ten years and a further 17% for between 6 and 10 years. The longevity of these businesses supports the success of franchising and supports the mitigation of risk when buying into a franchise.
- The last year has seen an increasing number of franchisors feeling that their businesses were at Success (achieving and nourishing) stage. The next biggest category is the Mature (control and profit) stage, which remained stable. There is a decline in the number of businesses that are described as being at the Ambitious stage (expanding, taking a risk), with some of these business moving into the Success stage.
- Fifty-nine percent of franchisors have business units/stores in shopping centres/malls and 62% have them situated in high streets, where most passing trade occurs. A quarter of the franchised outlets are operated from a home base or in an industrial area. Significant increases in the number of businesses on high streets (from 54% to 62%), and in industrial areas have occurred (from 17% to 23%). The move to the high streets is supported in the Franchisee survey (under separate cover).
- The main challenges facing franchisors remain finding the right person – in terms of finding the right franchisee with the right skills sets and the right staff. Other critical issues having outlets in the right location, the poor economy, and financing for franchisees.
- One in eight franchises claimed to be an international brand.
- The average amount of working capital required when buying a franchise is estimated to be R598k. The amount required as working capital varies considerably depending on franchise system. In this instance, Fast Foods and Restaurants and the Retailing sectors appear to require well above average working capital, while the Automotive Products and Services and the Building, Office, and Home Services groups require an average amount.
- For the upfront franchise fee, the average amount is R467k; the Fast Food and Restaurants and Personal Services franchisees appear to have to pay the highest upfront fees.
- The average management services fee was calculated at 6, 3% of turnover. These fees are highest in the Childcare, Education and Training sector and lowest in the Retailing sector.
- Marketing and advertising levies would cost a franchisee, on average, 2, 6% of turnover, with the figure rising to 7, 0% in the Health Beauty and Body

Culture sector and dropping to 1, 7% in the Automotive Products and Services category.

- Roughly a third of franchise owners claimed to make more than 100 payments and/or collections on a monthly basis to the franchise head office and franchised outlets.
- The incidence of using more than one bank for business purposes is low. First National Bank and Standard Bank are the most popular banks among these respondents.
- The number of franchisors who have a continuity plan in place for the franchise has fallen significantly over the last three years to 27%, from 42% in 2015. Among those who have a continuity plan in place, this is usually in the form of surety protection.
- Provisions in the case of ill health or frailty are implemented by the large majority of franchisors, mostly in the form of a life insurance policy. Most have a recently reviewed will in place (79%) and two in three do not expect a cash shortfall in their deceased estates.
- Investment portfolios, mostly comprising retirement annuities and/or property are to be found among the large majority of franchise owners and most have a personal retirement plan in place.
- Selling the franchise within the next 12 months, however, is not on the cards for 97% of franchise owners.