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A Guide to Franchising in Iran

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ABSTRACT

The world is getting smaller and smaller and none more so than in international business. It is paramount in today's global business environment (globalization and internationalism) that individual businesses look for new opportunities further a field than their own local market. Selecting the ideal international market and the entry mode you use to enter international markets outside of your domestic environment is critical to the ongoing success of your business and brand. One proven international entry mode is franchising. This paper will aim to make a contribution to the state of knowledge about franchising in Iran as a developing country with an emerging market. At first a review on the literature of the franchising strategy and emerging markets, then an illustration of the external factors in Iran which might effect MNE's and examining the effect of these factors on an existing franchise in Iran. I collected data in a qualitative case study and then applied the methodology. I conducted interviews as the main data collection tool as well as using secondary data in regards to the external environmental factors to include, case study of United Colors of Benetton, historical data and archival analysis on Iran itself. Research Problem: My research problem is to find out, according to the influence of external factors on using franchising as an entry mode into Iran, whether this is an opportunity or a threat. Method: United Colors of Benetton was chosen to conduct a case study of an existing successful franchise in Iran. Data was collected using a qualitative method and used to measure the effect of external factors influencing franchising as an entry mode to Iran Conclusions: In conclusion, with the current political climate in Iran, now may not be a good time to enter Iran, but certainly franchising is the best entry mode and Iran should not be dismissed as a good opportunity for MNE's when the political instability improves.

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INTRODUCTION

Franchising developed over time as an efficient way to do business and there were versions of franchising employed in Europe centuries ago. The origin of the word franchise goes back to Anglo-French, meaning *freedom, liberty*, and from Middle French, *franchir*, to free, and earlier from Old French *franc*, free. Franchising is clearly a powerful model to help people realize their dreams. Its success is manifested in the number of operating franchises, the number of brand names built through franchising; the millions of customers served every day, and the tremendous opportunity it represents to franchisees. Iran is a large country with a big population over 70 million. It has many past experiences within industrialisation and is situated in an important strategic geographical location, Central Asia and the Persian Gulf where there is a wealth of oil, and is fast becoming an emerging market. According to UNCTAD (United Nations Conference on Trade and Development), Iran is a good alternative for a corporation seeking big market size per capita income, market growth and access to regional and global markets.

This paper aims to illustrate the business environment in Iran and the effect of these environmental factors on existing franchisors' in Iran, and to find out the potential growth opportunities for new franchisors to enter and establish their brand within Iran.

RQ1: What are the external factors that might influence MNE's in Iran?

RQ2: How do external factors influence using franchising as a suitable entry mode into Iran?

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Methodology:

This is the chapter where the methodology used in the research of this thesis is explained. The data will be collected, a sample illustrated and analysed so that we may find answers to the research questions, and reassuring the purpose of the thesis.

Research Purpose:

There are three different types of research, namely; exploratory, explanatory and descriptive [35]. It all depends on how much knowledge or information the researcher has on the subject before starting the investigation and moreover, the type of information that would be required so that the purpose of the thesis is addressed. It is this final category, descriptive research that is to be used to define the study. That said, it will still have some elements of explanatory and exploratory. There is already a knowledge of franchising and entry modes, but in this research we aim to have a better understanding and knowledge of the methods of using an entry mode such as franchising to enter Iran and how the external factors will impact this. While the theocratic totalitarianism system of the government in Iran which has not had a good relationship with western countries can be a big barrier in addition. National government control of assets in Iran in last thirty years try to move to privatization has been pretty successful. Recently the Iranian government tried to communicate with global trade and be more active to international businesses. Liberalized the foreign investor and Investment regulations in a few categories: food, petrochemicals, the oil and Gas industry, vehicle manufacture, Copper mining, and Pharmaceuticals and joining global trade agreements such as ECO , GSTP and WTO (Trade Perspective'. Iran daily (2006-02-21) are the recent changes in Iranian government economic policy. The Prospect of Iran's economic and the extent of politic the economic is not clear yet .According to Lasserre (1998) wholly owned and Acquisition are not a suitable entry strategy into the market with such high political risk, but franchising as an entry mode with very low political risk is a good opportunity to enter into this emerging market and examine the market positional (maybe for more investment later).

According to the CIA fact book Iran has over $109 billion of exports in 2011, 80% of this amount being petroleum, and 20% was chemical and petrochemical products, Nuts and fruits and Persian carpets. While imports have been over $74 billion from abroad, for which the majority has been industrial supplies, capital goods, food stuffs and other customer goods and technical services (www.cia.org).

According to the CIA fact book in 2011 Iran just had $23.61 million stock of direct foreign investment at home! This put Iran the 65th country compared to other countries in the world.

Table below (table2) shows Iran protecting foreign investor against local firms ranked 150th compared to the other 185 economies. Strength of investor which is the average of extent of disclosure index, investor protection which we can see Iran has a very low (3.7), compared to the Middle East and North Africa and OECD. So we can summarise that while the table shows Iran's rank improved from 2012 by +17 it still does not have a very good level of investor protection.

Table 1:

Protecting Investors

DB 2013 RANK **150** DB 2012 RANK **167** CHANGE IN RANK **+17** View details » View methodology » Compare all economies »

Indicator	Iran, Islamic Rep.	Middle East & North Africa	OECD
Extent of disclosure index (0-10)	7	6	6
Extent of director liability index (0-10)	4	5	5
Ease of shareholder suits index (0-10)	0	4	7
Strength of investor protection index (0-10)	3.7	5.0	6.1

Another source of information which I found quit useful to give us an overview about Iran's economic opportunities and weaknesses was "doing business.org". "The doing business project provide objective measures of business regulations and their enforcement across 185 economies and selected cities at the sub national and regional level" by analysing comprehensive quantitative data to compare business regulation environment across economies during period time. In this paper I look at the Doing business 2013 report which was conducted during period of June 2011 to may 2012. The tables below show the overall "ease Doing Business" in Iran compared to other economies in Middle East and North Africa.

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Table 2:

Starting a Business

DB 2013 RANK **87** DB 2012 RANK **50** CHANGE IN RANK **-37** View details » View methodology » Compare all economies »

Indicator	Iran, Islamic Rep.	Middle East & North Africa	OECD
Procedures (number)	7	8	5
Time (days)	13	23	12
Cost (% of income per capita)	3.3	29.8	4.5
Paid-in Min. Capital (% of income per capita)	0.5	72.3	13.3

Source: Doing Business 2013

Table 3 illustrates the bureaucratic and legal difficulty which an entrepreneur will be faced if he wants to incorporate and register a new firm in Iran and compared it to the economy in the Middle East and North Africa. Starting a business got much more difficult in Iran in 2013 compared to 2012; their rank dropped -37 and stood in 87 ranks compared to other 185 economies across the world. If you look closely in this table we can see time and cost of starting a business in Iran is much more less than other economies in the Middle East and North Africa and very close to OECD. Iran's producer is a bit less than its region and a bit more than OECD. What is very surprising in this table is Iran has paid-in min. Capital, which is 0.5% of income per capita and significantly less than the Middle East & North Africa (72.3% of income per capita) and OECD (13.3% of income per capita). In conclusion despite Iran's rank dropping -37 it shows starting a business in this region, Iran is still one of the easy countries to start a business in.

Table 4 is showing Iran getting a credit ranking. As we can see getting credit in Iran improve 14 steps in the ranking table compare to other 185 economies and stood in 83rd position. The table shows strength of legal rights index of Iran is 4 out of 10 which is higher than Strength of legal rights index of Middle East and North Africa region (just 3 out of 10) but much less than the OECD index (7 out of 10). According to this table Depth of credit information index of Iran is 5 out of 10 which is similar to OECD and more than Middle east and north Africa region (4 out of 10). Look closely to this table shows the public registry coverage compare to private bureau coverage is slightly high in comparison to OECD, which according to what we said earlier in this paper it was production in Iran's economy (Government are the biggest economic runner in Iran).

Table 4:

Getting Credit

DB 2013 RANK **83** DB 2012 RANK **97** CHANGE IN RANK **+14** View details » View methodology » Compare all economies »

Indicator	Iran, Islamic Rep.	Middle East & North Africa	OECD
Strength of legal rights index (0-10)	4	3	7
Depth of credit information index (0-6)	5	4	5
Public registry coverage (% of adults)	25.9	8.6	10.2
Private bureau coverage (% of adults)	31.9	9.7	67.4

Source: Doing Business 2013

Table 5 shows paying tax in Iran ranked the 129 in 2013 which has -4 influence from 2012. Looking briefly in this table shows Iran take quite a bit more tax (44.1%) of investors rather than other economise in the Middle East and North Africa region (average 32.3%) even Iran take more than compare to OECD (42.7%). Basically compare to Iran rank in last year we can discuss Iranian government try to improve their income from tax income, which in a region like Middle East with some competitor like United Arab Emirates with 0% tax makes Iran less attractive for investors.

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Table 5:

Paying Taxes

DB 2013 RANK 129 DB 2012 RANK 125 CHANGE IN RANK ↓-4 View details » View methodology » Compare all economies »

Indicator	Iran, Islamic Rep.	Middle East & North Africa	OECD
Payments (number per year)	20	19	12
Time (hours per year)	344	184	176
Profit tax (%)	17.8	11.9	15.2
Labor tax and contributions (%)	25.9	16.5	23.8
Other taxes (%)	0.4	3.9	3.7
Total tax rate (% profit)	44.1	32.3	42.7

***Source:** Doing Business 2013*

Next table (table 6) illustrates the exporting and importing into and out of Iran in regards to time and cost of shipping which got more difficult in 2013. Iran Drop 4 steps in the table down compared to other economies and ranked as 143rd most costly and timely country out of 185 economies. Looking closely in the table below, we can see Time of export to Iran is 25 days which is more than double of OECD. Time of import even is higher than export, 32 days more than 3 time of OECD. Cost of export in Iran is $1470 per container which is more than $400 dollar more than cost of Middle East and North Africa and OECD. Also cost of import is almost double cost of import to OECD and Middle East & North Africa. In conclusion while Iran is in a very systematic area; access to Caspian Sea and Persian Gulf and Oman Gulf, cost and time of shipping because of the process requiring special document preparation (12 Days just for Document preparation) is very infuriating.

Table 6:

Trading Across Borders

DB 2013 RANK 143 DB 2012 RANK 139 CHANGE IN RANK ↓-4 View details » View methodology » Compare all economies »

Indicator	Iran, Islamic Rep.	Middle East & North Africa	OECD
Documents to export (number)	7	6	4
Time to export (days)	25	19	10
Cost to export (US$ per container)	1,470	1,083	1,028
Documents to import (number)	8	8	5
Time to import (days)	32	22	10
Cost to import (US$ per container)	2,100	1,275	1,080

Source: Doing Business 2013

On one hand we can see that protecting investors which includes; Extent of disclosure index, extent of director liability index, ease of shareholder suits index and Strength of investor protection index improved in the same period of time. Getting credit is improve by 14 rank in this table too which includes; Strength of legal rights index, Depth of credit information index, Public registry coverage and private bureau coverage. In general as this table shows doing and starting business in Iran has got harder over 2012-2013 while the getting credit got easer and local government tried to protect the investor more than before.

One of the other factors that a MNE have to be careful about a market is how to deal with customers and how to make a relationship with them. The different culture nowadays is one of the major areas that MNE research about before entering to a new market.

Horovitz and Kumar (1998) have argued that franchising is a good entry strategy into countries with a big culture distance to the host country. Costly adapting in the new culture caused franchisors to prefer to transfer the responsibility to the local partner, which is much more low cost investment, [32].

The worst thing about Iran's economy is the unstable currency exchange rate. Table (table 7) below shows from November 2011 to October 2012 the Iranian currency (Rial) on the Black market, dropped largely from more than 7.5 per 100,000 dollar to less than 3 per 100,000 dollar, and ranked the weakest currency in the world. Official Price of Rial is drop from more than 9 per 100,000 $ to a bit more than 8 per 100,000 dollar, The importance is according to the Islamic republic government law, government just subsidising just the absolutely necessary and essential stuffs, such as Food, Medicine and fabrics.

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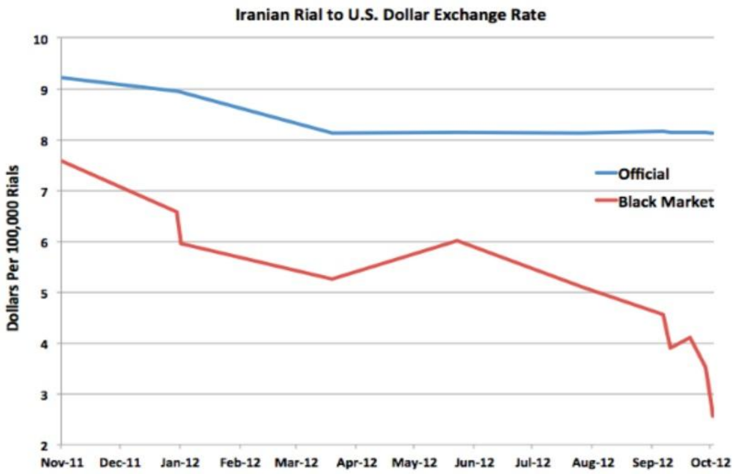
Table 7:



Source: Reuters 2012

One of the most current and important subjects about Iran is Economic sanctions. Iran has been the subject of two sanctions "The official United Nations Economic sanction and the unilateral sanction of united states (and more recently EU)" [22] sanctions are make effort on "export, restrict imports, and impede the flow of finance to target nation" [21] nations economic sanction "go through reduced markets for their products, pay higher prices for subsidised goods, and lose access to critical imports"(huffbauer 2007;45). Iranian legislation which includes the Islamic rule which is very strict about foreign product and establishment of tax in civil role will be a point of new sanctions in the world toward s Iran's target.

Case Study – RQ 2: How do external factors influence using franchising as a suitable entry mode in Iran?

There is a big gap between Iranian culture and Western brands. One of the points of franchising compared to other entry modes is because the manager is Iranian and was aware of these culture barriers, he was very successful in bridging the gap between the cultures. One of the biggest problems in Iran is the women are not independent and the majority of Benetton customers are women, so to some extent it will influence their sales.

The market size in Iran was very big and the company knew that there is a huge potential for growth, but the manager knows not a lot of Iranians have sufficient income to be able to afford Benetton's products. They know their target market was a specific of group of Iranians, not big population but a good population for a clothing product.

The biggest problem that the company is facing at the moment is the dollar exchange rate. The top manager mentions that the Iranian currency (Rial) dropped hugely in the last 14 months. This change in the exchange rate had repercussions in a big way for the company. First, they have to manage carefully buying the new stock, not ordering when the dollar is very high because it might drop the week after or ordering today because tomorrow the dollar price might go up. And secondly, their products now cost double, so their price in Iran increases by double too, which in turn affected their number of customers massively.

According to Benetton, as a Western franchise, religion and political issues were the biggest problem which they encountered in Iran, several of their stores were attacked by religious groups of people many times, which makes their sales consultants feel unsafe to work in a Benetton store. Benetton also has big restrictions from the Iranian government. Such restrictions are; they are not allowed to sell all type of clothes, there is an organisation in Iran (Amaken), that every week send a reporter to all their shops to check if their products are acceptable for a Muslim country or not. If the reporter reports any discrepancies their shop will close down for a while and they have to pay a fine to re-open the shop. The good point was because the franchisor running with a local manager and sales consultants, they were aware of these kind of problems and they knew how to solve it, a foreign manager would be struggling in the same situation.

The Headquarters try to do some management program and training courses but the majority of them failed, firstly because of the language barriers, secondly because the attitude towards work of Iranian employees is very different, their income is very low are they are not motivated that much, and the managers are not willing to increase their salary to motivate them. According to Benetton Top manager one of the reason for choosing Iran is the labour is very cheap here, so they can't see the point to pay extra income.

Benetton believe the long distance between the home country and Iran dose not make any problem, the problem in Iran despite access to the Persian Gulf, Oman Sea and Caspian Sea, is the shipping is very costly and takes a long time. The process after their order arrived in Iran, customs service is very long (usually takes a month). Laws and regulations in Iran are linked with religion too. They have to close on religious days, and in Iran they are open on Saturday and Sunday, instead they are closed on Friday which makes communication and ordering to the HQ very hard. As Benetton is now in Iran and known as the first, maybe just the only shop that customers can be sure they are not buying a fake product, the manager knows what Iranian customers are looking for, and supplies it.

Compared to Europe, the tax rate that Benetton are paying in Iran is a very low rate of tax, which sounds good for a European company but compared to the Middle East region the tax rate in Iran is not very good, for example tax rate in Iran neighbour, United Arab Emirates is zero.

Benetton's strategy was being a first mover in Iran's market and using first advantage. The biggest advantage of Iran's market is there is almost no competitor at all. The Benetton product quality is much better than local producers and the other thing is Benetton carrying the United Colours of Benetton name as an Italian brand, which makes it very hard for local producers to be able to be competitive. None of the other international clothing brands have been as successful as Benetton. Benetton opened franchises in more than 15 cities in Iran while no other competitor has achieved this. Now people all around Iran are familiar with the Benetton logo, the Benetton logo is now paired with Italian clothing and high fashion for Iranians.

The top manager was saying that according to high uncertainly environment Franchising was just the only way that a western brand would be able enter Iran, the other entry modes are too risky and not really suitable for such a country.

Data Analysis:

The data analysis will be the analysis of the empirical data received during the interviews.

Research Question 1 – Case Analysis:

Theory by Koch[26]:

Koch [26] states that the following factors are the external factors, industry feasibility/viability of franchising MEM, characteristic of the overseas country business environment, market growth rate, global management efficiency requirement ,image support requirements, popularity of individual MEMs in the overseas market and market barriers. Global management efficiency requirements were not taken into account in this case study.

Industry feasibility/viability of MEM:

Koch [26] theory heavily based on target country specific factors such as: law and regulations, technical know-how dissemination risk, labour cost and insufficient level of skill etcetera. According to the research, labour cost in Iran is very low, which through the case study the Benetton mentions it as a good point of Iran's market. Our finding suggests the Law and regulation in Iran is not established yet, and its changes daily, in the case of Benetton the company states there are very specific laws about clothing in Iran which needs special knowledge to deal with, which a franchise because it is operating with a local manager and team has more power to understand it and deal with that, in the case of Benetton it seams the lack of management skills effect the labour become unmotivated.

Market Growth rate:

Koch [26] states if a market is growing at a fast rate and demand in the foreign market is in its early stages and anticipated to be very large in the forthcoming several years, establish own marketing / manufacturing subsidiaries could be a far better idea. [26]. Our finding shows Iran's population is very high and the population rate is growth very fast, but distribution of family income in Iran is ranked very low compare to all around the world and Iranian unemployed rate is kept growing in the last few years.

In the case of Benetton our finding shows that the majority of the Iranian can not afford to buy Benetton's product, plus Benetton states the number of their customers has decreased during the last year because of the dollar exchange rate effect their products price, and now not even all their previous customers are able to buy exported product.

Theory by Root [31]:

Target country market factors:

According to Root [31] small markets require minimum investments levels and look to prefer entry modes with low breakeven sales volumes. High breakeven sales volumes are able to offer a platform for high sales potentials which can justify such an entry mode. The research shows the population in Iran is very high which seems a big market target, although the number of unemployed and low income levels in Iran reduce the target market, according to Benetton's case the Benetton consumers are very small and a specific part of the Iranian population. So in this case franchising as minimum investment level was better choice than some large investment modes like subsidiary which needs a lot of investment.

Root [31] also discusses and states that the competitive structure is a large dimension in the target market. According to Root [31], for target countries/markets where there is dominant competition and equity or export entry mode is not a viable solution then companies can look to use licensing or some form of contractual

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agreement modes. While the case of Benetton entering into Iran as a franchisor (contractual entry mode) and states the reason they succeeded is there was not a lot of competitors in Iran and make a loyalty brand in Iran because of lack of competitor . If they would have chosen export entry mode they would not be able to make such a big relationship with their consumer.

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Conclusions:

This paper can conclude that although there is a large population in Iran and the potential for a large market, this market is not suited to MNE's owing to high unemployment rates and low incomes of the majority of Iran. This has significantly reduced the target market of people willing to pay for a Western Brand such as Benetton. This coupled with many other factors that I will illustrate below leads to the conclusion that franchising is the best entry mode to enter Iran as a foreign company.

Entry modes, such as wholly owned subsidiaries or joint ventures require high investment levels and are more suited to larger target markets that can share greater profits.

Starting a business in Iran has been getting harder and harder recently with no signs of it getting better soon. Companies need credit to start up often and getting credit is very difficult as it is all over the globe in the current economic climate. Tax rates are on the up as part of the second phase of the economic reform plan (2011), from what is already a very high tax rate.

Foreign investor and trading processes, which although improved within the last year are still not good for an investor, and foreign investors are still going to have to deal with strict political laws and regulations. These processes and restrictions coincide with each other and make foreign investment in Iran unattractive proposition at present. This points to franchising as being less risk and a good choice of entry mode with a lot of potential provided a few behaviors by the franchisor/franchisee are adopted. The franchise needs to be run and have a local Top Manager who is aware of the political laws and regulations that put up barriers for business. The Top Manager ideally should be from the same religious background as religion is very prominent in Iran and affects the way business is done.

Franchising transfers the all the cost and investment to the local investment and consequently is much safer than any other entry mode because of this.

Geographic distance in the 21st Century does not have a major influence on foreign companies in my opinion, but what does have a large influence is the difference in cultures, which in Iran case is often related to religious differences in culture. As mentioned earlier it is paramount and key to the success of the business that an understanding of the local culture is prominent, and with franchising this is achievable through a local Top Manager.

Labour costs in Iran are low and of course this is attractive to foreign companies and a good reason for a company to enter Iran. There are not too many MNE that exist in Iran and local competitors are generally not strong enough to be able to compete with large MNE's. This is a good window of opportunity for a franchisor to expand internationally into Iran and grow the brand globally. We have seen that in the case of United Colours of Benetton, they set a precedent by being a first mover in Iran and subsequent MNE's can learn a lot from their experiences overcoming the hurdles of local risks and barriers.

Having said that franchising is a good entry mode and there are good opportunities in Iran provided an understanding of local cultures, religion and politics are there through a local top manager, caution is suggested as at present inflation is running very high and the Dollar exchange rate is plummeting, largely owing to the sanctions that Iran is currently facing.

In conclusion, with the current political climate in Iran, now may not be a good time to enter Iran, but certainly franchising is the best entry mode and Iran should not be dismissed as a good opportunity for MNE's when the political instability improves.

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