

CZECH UNIVERSITY OF LIFE SCIENCES PRAGUE



Faculty of Economics and Management

Department of Economics

Franchising: Concept of business model

Diploma Thesis

Author: Petra Vašková

Supervisor: Ing. Šobrová Lenka, Ph.D.

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I declare that this diploma thesis is my own work and that the references include all the sources of information I have utilized.

In Prague on 6.4.2011

.....

Petra Vašková

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FRANCHISING: CONCEPT OF BUSINESS MODEL

FRANCHISING: NÁVRH PODNIKATELSKÉHO ZÁMĚRU

SUMMARY

This diploma thesis deals with the issue of franchise business. It is focused mainly on the position of franchisor and an effort to set own franchise network. It analyses the use of franchise business in practice. Important point is to create a franchise business pilot project proposal for real company, which is for the purpose of this thesis called Lentil Ltd. This company would like to extend its business and make the best of its potential. Franchise business conception can help Lentil Ltd. to expand the market with less capital intensive than in case of carrying business on its own. Establishing a new premise as a pilot project of franchise business should verify and demonstrate if analysed business is successful and viable. Thus this diploma thesis tries to unify and complete company current way of doing business so that it can form a unific network, which would be saleable as a complex system in the future. An inherent part of this process is assessment of company existing economic situation and performance. It is essential for realistic and well-founded results and outcomes. Thus substantial theme of this thesis was the question if expansion of Lentil Ltd. on the franchising form of business could be feasible, successful and profitable project in economic and business way.

Key words

Franchising, franchisor, franchisee, franchise business concept, franchise agreement, franchise package and manual, process of creating franchise network.

SOUHRN

Tato diplomová práce zpracovává problematiku franchisingového podnikání. Je zaměřena zejména na pozici franchisora a na jeho snahu zavést vlastní franchisingovou síť. Analyzuje využití franchisingového podnikání v praxi. Těžištěm práce je vytvořit návrh franchisingového pilotního projektu pro reálnou společnost, jenž je pro účely této práce nazývána Lentil s.r.o. Tato společnost by ráda rozšířila své současné podnikání a využila jeho potenciálu. Franchisingové podnikání by pomohlo firmě Lentil s.r.o. expandovat na trh s nižšími investičními náklady než by tomu bylo v případě čistě vlastní podnikatelské sítě. Pilotní provozovna potenciální franchisingové sítě by tedy měla ověřit a prokázat, zda je analyzovaný podnikatelský koncept schopný úspěchu a dlouhodobého fungování. Tato práce proto sjednocuje současný způsob podnikání tak, aby mohl být v budoucnu prodejný jako komplexní, jednotný a fungující systém. K zajištění reálných a podložených výsledků je součástí tohoto postupu zhodnocení současného ekonomického stavu analyzované společnosti. Důležitým tématem této práce je tedy otázka, zad-li by využití franchisingové formy podnikání bylo pro Lentil s.r.o. možné, úspěšné a profitabilní jak z ekonomického tak obchodního pohledu.

Klíčová slova

Franchising, franchisor, franchisant, franchisingové podnikání, franchisingová smlouva, franchisingový balíček a manuál, proces vytvoření franchisingové sítě.

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1. INTRODUCTION

Nowadays in the era of global competition, when the majority of market is divided among multi-national companies, it is still more difficult for small and medium-sized businesses to succeed and survive in the market. The unregulated part of the market is distinguished by supply overhang. Quantity of substitutes on the market is enormous. Also current business environment in the Czech Republic is influenced by many factors, which are posing a risk mainly for small and medium-sized companies (e.g. constantly changing legal and administrative environment or complicated bureaucratic procedures). Those companies have harder position in the market also due to relatively higher costs involved. One of the possibilities how can small or medium company compete with large companies in this challenging environment, is franchising. This system is beneficial either for franchisor as well as for franchisee. It affords to reduce and spread some kind of costs between both parties, as well as to avoid risks connected with doing business on its own. Other advantage offered by this system is also relatively high profitability of capital invested.

This diploma thesis is focused mainly on the position of franchisor and his effort to set own franchise network. Its beginning idea was to design a comprehensive and complete franchise business system for real medium size business company operating in the field of gastronomy. To keep its anonymity, for purpose of this diploma thesis, the company is called Lentil Ltd. and its enterprise Lentil Buffet.

Lentil Ltd. currently operates only one establishment. Present status of enterprise gives the impression of average medium to small size company, which is profitable and its economic situation is very good. Despite this fact its prosperity has not significantly increased last two years and remains on quiet similar level. That's why its owners would like to extend their business and take advantage of its potential, which significantly does not have a space for farther growth. The form of franchise business

would help Lentil Ltd. to expand the market with less capital intensive than in case of carrying business on its own.

Nevertheless deeper study of the issue showed, that such proposed instant way of creating franchise network is not feasible in practice. Every company which wants to create a franchise business concept should first own and maintain a larger number (small network) of its own business premises at its own cost and risk, which prosper. This should prove and verify if given business system is operational in various conditions and if it has a potential to be successful and salable to other parties. No beginning businessman would be willing to invest capital into the system, which hasn't proven performance.

Above mentioned facts led to the decision follow the practice and to design and calculate business plan for new premise which will be maintained by current entrepreneur. The aim of this establishment will be to verify and demonstrate that the analysed business is successful and viable. Therefore it would serve as pilot project of future possible franchise network, which could be in the future outlook sold to other undertakers (potential franchisees).

Thus the proposal of franchise business concept in this thesis seeks to unify and complete the current way of doing business so that it can begin to form a unific network, which would be saleable as a complex system. It would be a business plan leading ultimately to a franchise network, where the company Lentil Ltd. would act as franchisor.

2. AIM AND METHODOLOGY

2.1. Aim

The aim of this diploma thesis is to analyse the topic of franchising business and its use in practice. This main objective is possible to subdivide into several partial aims. First one is to cover the theme theoretically and create a starting basis for practical application. Theoretical part should introduce in the topic of franchising and highlight its crucial points. Further partial aim consists in application of franchise business system on existing company. This company wants to expand on the market through creating own franchise business conception. To solve this topic, it is necessary to assess company's current economic situation and find out whether is its business concept viable and profitable in long-term period. Another step should verify applicability of franchise business concept in practice. Inherent part is the financial analysis and calculation of new premise which should verify if the project could be profitable and feasible from economic point of view. Integral component is concept unification of existing business. This process ought to clarify if Lentil Buffet is capable to perform well as a unified system.

Whole process should get across the question whether is the use of own franchise network feasible and profitable way how to expand.

2.2. Methodology

The theoretical part of this diploma thesis is based on search of special literature as well as other relevant information sources relating to the issue of franchising. Obtained information was divided into relevant and complementary one. Consequent recherche of such classified information helped to frame a theoretical base, which was an important starting point for the practical part.

Second part of diploma theses processes the theme of franchising on practical example. It is divided into two major points. The first one is targeted on existing business company and its present business situation. Second one designs a future business pilot project. Analysis of current business activity is important to demonstrate that the business concept is prosperous and profitable in long term period. Therefore has been calculated a financial analysis which covers last three years of operation in period from 2008 till 2010. This analysis compares company business performance in mentioned time period and is finished with profit and loss assessment. Data used in calculations were taken from financial and tax record documents obtained from internal sources of the company. Because tax record data are limited, in order to avoid incorrectness of outcome results, some calculations have been done after consultation with Lentil Ltd. management.

Following part is focused on financial calculation and costingness of future Lentil Buffet. This part includes profit and loss projection and consequently assesses economical effectiveness of intended project through Break-even point analysis. Calculations use previously analysed data from existing business and are worked out with regard to possible directing by franchisee. The financial planning takes in consider a largeness of future establishment and a size of expected demand. In order to be actual and realistic, stated levels of various indicators are determined on the basis of Lentil Ltd. expert estimations. Calculations also follow current prices of real property and gastro equipment on the market.

Integral part of pilot project is proposal for unified business concept. This proposal results from analyses of current business system, identification of its weak and strong points and its integration in one business system.

This diploma thesis also uses information and advices obtained from interview with legal franchise consultants Mgr. Šimona Mašek and JUDr. Petr Mašek.

3. LITERATURE OVERVIEW

3.1. History of franchising

3.1.1. Franchising in the world

In the history of the world franchising is still not clear who, when and to whom sold the first business license. The roots of the word "franchise" goes back to the beginning of the second millennium.

In the Middle Ages licenses to carry out certain activities (e.g. use of forests for a fee or providing some service, organizing markets as well as trading in particular region, etc.) grant kings or church representatives.¹

American roots

USA is recognized as the cradle of modern franchising. Precursor is not McDonald's (the most popular example of business under license) but American businessmen Isaac Singer and John S. Pemberton. I. Singer was a producer of sewing machine. In the middle of 19th century he created a network of dealers, who were allowed, due to paid license right, sell his products in determinate area.

At the end of this century, John S. Pemberton, the inventor Coca-Cola, decided to make his know-how accessible to the beverage producers, so that they were able to produce and sell exactly the same Coca-Cola, which Pemberton invented.

Development of motorization in 30th of 20th century forced car manufacturers to find new ways of selling and as a perfect solution were dealer networks of selling places, which operated on franchise principles very similar to current product distribution

¹ PROFIT SYSTEM FRANCHISE SERVICE. *Český portál o franchisingu* [online]. 5.3.2008 [cited 2010-08-26]. Available on: <<http://www.franchisinginfo.cz/abc-franchisingu/1/historie-franchisingu/>>.

After World War II, was franchising in the USA developing primarily in the area of service and gastronomy.

Franchisees gain knowledge related not only with the sale of a product or a service, but they also learned how to run whole enterprise (from the visualization of the place of business or uniforms of personnel through means of services implementation, customer service, to the promotion and marketing). This model can be finally called franchising. USA franchisors developed their networks very dynamically and soon they began to expand into Europe (in the 60th).²

3.1.2. Franchising in the Czech Republic

The beginning of the development of franchising in the Czech Republic dates back to 1991 when first foreign franchise systems began to join our country. However insufficient knowledge of franchise system and certain distrust among entrepreneurs impeded to its fast expanding and use. There was a lack of specialized education seminars, suitable literature as well as counselling services supply.

Other important factors influencing the slow development of franchising in the Czech Republic were funding, underdeveloped entrepreneurial culture of Czech market, imperfect legislation and legal awareness, low quality of management, lack of know-how and insufficient experience with this form of business.³

This problem was partly solved by the establishment of the Czech Franchise Association in 1993 as a non-profit, professional organization. This organization associates national franchising providers and experts. Its members are large, well-known, international franchise systems as well as smaller domestic companies.

² PROFIT SYSTEM FRANCHISE SERVICE. *Český portál o franchisingu* [online]. 5.3.2008 [cited 2010-08-26]. Available on: <<http://www.franchisinginfo.cz/abc-franchisingu/1/historie-franchisingu/>>.

³ CZECH FRANCHISE ASSOCIATION [online]. c2005-2009 [cited 2010-08-26]. Available on: <<http://www.czech-franchise.cz/franchising/franchising-v-cr/>>.

Association is focused on promotion of existing franchise systems and tries to keep positive conditions for development of this kind of business. Its object is to represent this form of business, be its expert guarantor, inform amateur and professional public, associate business entities, provide support services, assist in obtaining important information and other key activities. According to statutes of the Czech Franchise Association, regular member may become a natural or legal person which is in conformity with defined condition, after decision of the Czech Franchise Association Executive Board. Regular member can be any domestic business entity, which applies franchising as a distribution system for a minimum period of one year and has at least two franchise leaseholders or holds a master franchise license for the Czech Republic from renowned franchise company.⁴

Nowadays, there is a group of about 130 franchise concepts or concepts that have certain characteristics of franchising in the Czech Republic. One half of this group is from area of services and the second half are business concepts. Main interest of franchise concepts isn't opening their own establishment. To gain new franchise partners and open new franchise establishments is more interesting. The largest category of concepts is from field of restaurants, cafes, tearooms and fast food. Another major group is from real-estate area. Concepts of trading in fashion and cosmetics are also strongly represented. Obvious is also every year increase in supply of franchise systems, very often from European countries. One third of the concepts in the Czech Republic is operated more than 10 years. The oldest systems are McDonald's, Yves Rocher and OBI. Foreign concepts and concepts from the Czech Republic are represented at rate of 1:1. The duration of the franchise contract ranges from 2 years to 20 years. Most common are medium-term contracts for 5 years. Long-term contracts for 10 to 20 years are made by networks whose business requires an investment of more than 3 million CZK and its pay-back period reaches over four years.

⁴ CZECH FRANCHISE ASSOCIATION [online]. c2005-2009 [cited 2010-08-26]. Available on: <http://www.czech-franchise.cz/?page=asociace_zakladni_informace>.

According to the Czech Franchise Association franchising and its demand is not just a matter of fashion, but a logical consequence of changes in the European and Czech market. It offers many benefits, from higher safeness for business activities to a relatively high profitability of paid capital. Franchising is applied mainly for small and medium business and according to the Czech Franchise Association in last years the demand for this type of business is increasing – particularly on the part of midsize or beginning entrepreneurs. Franchising is becoming an alternative to their further business development and can also help to succeed in challenging open EU market environment, which includes also the market of the Czech Republic.⁵

3.2. Characteristics and definition of franchising

At present, there is no unified definition of franchising. Various definitions given by associations of particular countries (as the German Franchise Association, International Association of American franchisors and mainly the European Franchise Federation) may help to take bearings in this issue. European Franchise Federation defines franchising as a form of contractual cooperation between legally independent entrepreneurs based on equal rights, where one side is a franchise entrepreneur "franchisor" (who is the licensor) and the other side is made by one or more "franchisees", who receives rights and obligations connected with using the license. European Federation also understands franchising as a distribution or sales system which allows cooperation of separate and financially independent business subjects. Thanks to this system is franchisor able to take a strong position in the market at relatively low cost and risk. Therewithal franchisee acquires certified and proven know-how relating to sale, technology or business management. At the same time franchisor enables franchisee to use already established trade mark, this privilege is

⁵ CZECH FRANCHISE ASSOCIATION [online]. c2005-2009 [cited 2010-08-26]. Available on: <<http://www.czech-franchise.cz/franchising/franchising-v-cr>>.

requite by regular franchise fee. Mutual relationship between those two sides is lined up by a franchise contract. A franchise network can be considered as a result of franchise business expansion (Řezníčková, 2004).

Conformably to European Franchise Federation “know-how” is set of non-patented practical knowledge which is secret, substantial and identified and results from franchisors gained and proved experience.

An important document governing the functioning of franchise system is European Code of Ethics, which was draw up in 1972. It contains above mentioned definition of franchising as well as rights and obligations o franchisor and franchisee and also fundamental terms of franchise contract. One of main principles of Code of Ethics is decent mutual relation between both sides together with their willingness, honest and round dealing.

“Franchisor is the initiator of a franchise network, composed of itself and its individual Franchisees, of which the Franchisor is the long-term guardian.”⁶

The phrase franchising can be also understood as an expression for variable marketing systems. Franchising can be found in a form of: manufacture of patented products based on license provided by patenter, whereas the part of license is also trade mark as the right of manufacturer; distributor agreements or license contracts under which is receiver of license able to perform specific business using brand name and trademark owned by the licensor. On the base of this contract is licensor able to control, how its receiver is doing his business and to provide him ongoing assistance and advice in needful areas. This type of franchising is known as a business franchising (Loebl, Lukajová, 1994)

⁶ EUROPEAN FRANCHISE FEDERATION. *European Code of Ethics for Franchising* [online]. 19.9.2008 [cited 2010-08-26]. Available on: <<http://www.eff-franchise.com>>

From above mentioned is possible to say, that for franchising is typical long-term contractual cooperation between both parts, legal and partly business autonomy of franchisee, franchisee's obligation to keep particular defined manners, vertically organized structure, the right of franchisee to use brand name and trademark of franchisor as well as his manufacture and business secret, know-how, image, experience together with sale and marketing programs. Franchisor also should have the right to manage and control franchise system.

3.2.1. Franchisor and his obligations

To fulfil his/her obligations, franchisors should meet some characteristics. His/her business should bear brand name, word label or a symbol (eventually trade name) for production/business activities or services, but also a symbol of experience, knowledge (know-how) and franchisee is entitled to use it. The company should also have certain products or services, which are determined in original and precise framework. Franchisee is able to use and take over this concept, which is based on specific and proven marketing techniques. Because franchisee has the right to benefit from available brand name, trade mark, marketing conception, technology and know-how of franchisor, can be this system considered as superior to other ones (Jakubíková, 1997).

European Code of Ethics describes duties of franchisor. Franchisor shell operate a successful business concept for reasonable time with at least one pilot unit before starting its franchise network and he/she should also provide to franchisee initial training and continuing commercial and technical assistance for the duration of validity of franchise agreement.⁷

⁷ EUROPEAN FRANCHISE FEDERATION. *European Code of Ethics for Franchising* [online]. 19.9.2008 [cited 2010-08-26]. Available on: <<http://www.eff-franchise.com>>

3.2.2. Franchisee and his obligations

Franchisee that has been chosen by franchisor should also meet some criteria as: being truepenny; have basic theoretical knowledge about franchise business and its key aspects; be ambitious to assert himself and establish his business on market; have own capital and financial funds; be willing to cooperate and be conform with defined rules of franchise network, especially to accept the right of franchisor to control the business. Further to be capable to manage a team of employees or have organization abilities (Czech Franchise Association, 2008)

European Code of Ethics also highlights that the individual franchisee constantly endeavours to the grow of the franchise business and sustenance the common identity and reputation of franchise network. Franchisee must supply the franchisor with veritable operating data and necessary financial statements (and allow the access to those records) to facilitate the determination of performance and effect management guidance. He should allow the access to premises of business and can't disclose to third parties the know-how provided by the franchisor, neither during nor after termination of the agreement.⁸

3.2.3. Types and forms of franchising

Franchising can be classified according to different criteria. It is possible to distinguish between type and form of franchising. Following chapter describes types of franchising as first, than it deals with theme of forms.

Types of franchising can be based on: historical aspect, aim of franchising, character of parties involved, vertical classification, relation to third parties, territorial criteria, exclusivity. Taking in consider **historical aspect**, historically older type is so called

⁸ EUROPEAN FRANCHISE FEDERATION. *European Code of Ethics for Franchising* [online]. 19.9.2008 [cited 2010-08-26]. Available on: <<http://www.eff-franchise.com>>

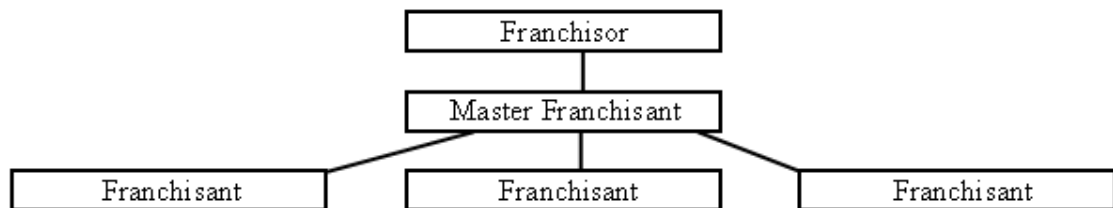
product franchising, which was applied for particular patented products. Among another franchisee obtained sale license and access to accurate description of manufacture process. More complex and today even more common is form of business-franchising (sale franchising or package franchising). It is kind of “turnkey” business, where franchisee obtains proved and certified business idea together with assistance in searching place for establishment, help in managing the business and eventual financial support. This type is typical for sphere of services (Řezníčková, 2004).

There are following types according to **aim of franchising**: industry franchising, which is focused on the manufacture of products; distribution franchising focused on selling products; franchising in sphere of services and wholesale oriented franchising. Following the **character of parties involved** it's possible to find franchising among natural persons as entrepreneurs; franchising among legal subjects or mixed franchising (among legal and natural subjects). **Vertical classification** distinguish between single-stage franchising, where is franchising provided only at the same level and multilevel franchising which provides several levels of franchising. With refer to **relation to third parties**, there is master-franchising and simple franchising. Master franchising enables the right to provide franchising to further subjects (subfranchising). At that moment franchisee becomes a quasi franchisor – even with limited privileges in a specific area. Simple franchising which does not allows franchisee any activity that might lead to disclosure of important information and data to third parties. In other words franchisee is not entitled to carry out master-franchising (Hirsch, Peters, 1998).

The **territorial aspect** diversifies national franchising, which is realized only on national level and international franchising provided also abroad. Based on **exclusivity of goods**, it is possible to find minifranchising which is used for exclusive goods from exclusive companies for small number of customers. Franchisor provides the distribution right only to previously determined area. There is special store

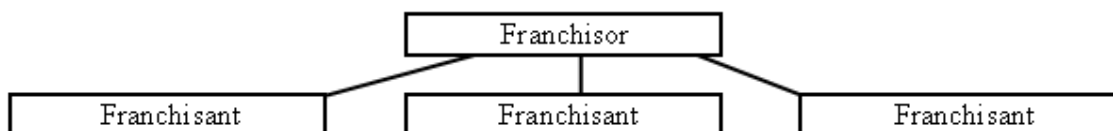
equipment, promotion material and prescribed prices (Řezníčková, 2004). Following illustrations show example of master and single franchising in graphical form.

Illustration 1: Master franchising



Source: Řezníčková, M.: *Franchising: podnikání pod cizím jménem*. 2. pub. Prague: C. H. Beck, 2004. 205 p. ISBN 80-7179-894-0. p. 12

Illustration 2: Simple franchising



Source: Řezníčková, M.: *Franchising: podnikání pod cizím jménem*. 2. pub. Prague: C. H. Beck, 2004. 205 p. ISBN 80-7179-894-0. p. 13

In special literature is also possible to distinguish forms of franchising. There are two basic forms: product distribution franchising and business format franchising. Product distribution franchising is cooperation between franchisor and franchisee based on distribution of particular products. Franchisee sale the latest products under the brand name or trademark in frame of limited distribution network. Business format franchising places emphasis on firmer connection between franchisor and franchisee. Franchisees business activities are supported more complex, either before or during the business process (Megginson, 1988).

3.3. Advantages and disadvantages of franchising

If we want to look on advantages and disadvantages of franchising and compare them, we can do it in several ways. We can measure them in general point of view or to use them in relation to the franchisor or franchisee. According to fact, that franchising is a form of business cooperation among independent entrepreneurs, it is natural that both sides will make an effort to minimize disadvantages and to maximize advantages. Therefore they should keep in mind their common objectives, which are mainly: advantageous market position; lower costs; realistic financial management and smart management organization (Řezníčková, 2004).

3.3.1. Advantages of franchising

Advantages for franchisor

Franchising has advantages for both, franchisor as well as franchisee. Franchisor can profit from advantages of organization, which is composed of several highly skilled managers who are specialized on particular aspects of the business. Organization can earn reasonable profit without being exposed to high capital risk. There is no need of massive capital injection to achieve rapid grow and organization is able to accelerate its development either on national or international lever with minimal capital risk. Thanks to franchisees local interests and experiences is easier for franchisor to expand on unrecognized areas or regions. Finally, franchisor has fewer problems with personnel, which is mainly the matter of franchisee in his individual premise (Mendelson, Acheson, 1994).

From benefits mentioned above is obvious, that the cornerstone of successful franchise network development is capital modesty as well as delegation of responsibility on other involved persons.

Advantages for franchisee

Franchisee can enjoy an advantage of rapid market access, reduction of risk arising from self-employment and higher security in business. He/she is entitled to use the logo, trademark, image, collective promotion, brand name and goodwill, which are already tested and in customers' awareness. Franchisee acquires already pre-tested and approved actual marketing conception and extensive current know-how gained through education and training (either before as well as during the running of the business). He/she can gain from image of big stable company and make use of company's popularity, name, logo, advertising campaigns, participation on fairs, etc. Franchisee has right to target consultation and stable communication with his franchisor. Franchisor also trains staff (Řezníčková, 2004). Further advantages are:

- Higher earning with cost optimization.
- Product line is already developed, tested and protected. Franchisor helps to complete the range of goods and eliminate problems with supply. It is based on so-called pilot project under which is carried out a survey on the most appropriate mix of product line for particular area, so that franchisee don't have to frame and complete the mix of products separately. Supply to all enterprises involved in the franchise network is carried out through a unified supply system, which ensures supplier determined by franchisor.
- Better financial turnover, purchase and sale benefits thanks to involvement in wholesale supply system which enables low cost purchase of goods.
- Assistance in price regulation. Franchisor has pre-processed price levels for particular areas. However the final price is set by franchisee. There is also
- Tax, accounting, credit and consulting services from franchisor.
- Higher financial credibility. Banks are more willing to provide loans to subjects with once proven business plan. Large financial institutions have usually special departments or teams of specialists focused on franchise business (Mendelson, Acheson, 1994).

3.3.2. Disadvantages of franchising

Beside mentioned positives brings franchising also some disadvantages. Therefore everyone who wants to start with franchising system should be prepared to take certain compromises. The business concept is finished and fixed and partial changes are rarely possible. Interests of other members of franchise system must be always taken in account and it is especially franchisee must adapt. There is high degree of transparency, since franchisor knows all important data about franchisee. Franchise systems with lot of members tend to bureaucracy. There is always a risk that there won't arise cooperation between franchisor and franchisee, but hierarchical relationship – that the franchisor will just directly manage franchisee instead of providing guidance and protect.⁹

Disadvantages for franchisor

According to the work of Mendelson and Acheson the fact that within franchise network has franchisor a smaller number of workers does not mean that it will remove all “problems with people”. Any potential provider of franchise license should be aware of importance of good relations. Good relationship is an important aspect in successful business. Many of following disadvantages are directly or indirectly connected with “problems with people”. Get people who are suitable for being franchisee is not an easy task. Some franchisee tend to be fully independent. This feeling often grows in proportion to their success, so that they sooner or later think that the reason of their success is good management of their own business and own sedulity. Provider of franchise should constantly check and monitor whether there are in whole franchise network adhere standards relating to quality, service and goods. On the side of franchisor may also arise fear, that he is training his possible future

⁹ CZECH FRANCHISE INSTITUTE [online]. c2009 [cited 2010-09-02]. Available on: <<http://www.ifranchising.cz/franchising.php>>.

competitor. Within some mean it may be true. However in practice is the number of franchisee who subsequently become independent is not very high and on the other hand there are also some legal consequences and sanctions. Quiet problem is if franchise fees are paid by a certain percentage of gross income, franchisee than may not report information about his gross income correctly, that also reflects a lower level of control (Mendelson, Acheson, 1994).

Good franchise agreement can from a large part minimize above mentioned disadvantages. Franchise agreement is very often under trade secret and drawn up very strictly for the benefit of franchisor.

Disadvantages for franchisee

Control of business activities by franchisor is one of drawbacks for franchisee. Franchisee should reconcile with the fact that in the interest of successful business franchisor has right to control his business activities even that officially is franchisee independent entrepreneur. Partially restricted entrepreneurial freedom should be also take in account. Further franchisee isn't able to realize and implement his own business plans and achieve major success in the market or to gain larger market share than which is defined by franchise agreement. Initial investment tent to be very high and that's why it is not possible to count with return on capital immediately after business start-up. However franchise agreement should be set up in order to ensure franchisee amortization of his initial investment. There are some fees which shall franchisee pay to franchisor – either for franchise services rendered, promotion fee or regular percentage of profit. It can be for example: license fee for using registered trademark, assignation of know-how rights and exclusive rights to sale, technical assistance for start-up or initial training and other. More regular payments are payments for the image, the continuous assistance, professional training, improvements in the product line (which is basic responsibility of franchisor) or payments for research and innovation. Franchisors first option of purchase may be a

part of dispute as well. According to franchise contract franchisor usually reserves the priority right to buy back business premises submitted in franchise network. There is an obligation to be supplied by products or services, which are determined in franchise contract (even if their sale is complicated or problematic). According to franchise contract must franchisee share the profit with franchisor (Řezníčková, 2004).

3.3.3. Friction between franchisor and franchisee

Aforesaid disadvantages which can have impact on both parties of franchise relationship are principal and crucial. Therefore everyone who wants to start with franchise business should consider carefully whether he is willing to accept them and whether drawbacks does not outweighs the benefits. Disadvantages are also causes of friction between franchisor and franchisee. Possible conflict in franchise relationship can arise in case that some franchisee doesn't maintain soundness and good image of the firm or refuse to voluntarily participate in promotion campaign, tries to promote competition goods and does not observe set rules (manufacturing and production processes, distribution methods, etc.). Franchisor can't accept this kind of franchisees behaviour at any time. On the other hand franchisee can be upset if franchisor opens new business premise nearby franchisees existing establishment. Extensive high fees, bundling control from franchisor or unwell-developed marketing concept can be source of dispute as well (Jakubíková, 1997).

Emerging friction can arise in different intensity, from standard disagreement over open conflict up to legal process. Franchisor can prevent these potential conflicts by exact setting of rules and activities, supervision of sale promotion and propagation (e.g. setting the list of goods which is franchisee allow to purchase alone and which not or determination of range of information which will franchisee receive from franchisor). In past was strong position of franchisor common case, but current

situation is different. There are brand corporations and associations, which tries to regulate mutual relations.

Altogether if we weigh all advantages and disadvantages, they will be in balance and this balance is probably the reason why franchising is so popular today.

3.4. Process of creating a franchise network

The process of establishing franchise network is composed of several parts. Indispensable condition for its successful implementation is not only a franchise contract (the legal basis for every business) but also franchise hand book, package and manual and so-called control questions system that must be processed before contracting proper agreement.

Further very important point is pilot project, which is responsibility of future franchisor. It is this very project which should prove operation ability and efficiency of the future business. In addition, the implementation of the pilot project is embedded in the Franchise Associations Code of Ethics.

Franchise handbook

Every company providing franchising should have franchise hand book. The aim of this hand book is to describe particular franchising system. It usually contains a range of products, services and technologies, the level of initial investment and regular fees, rules of using patents and trade mark, franchisee's obligations, conditions of partnership and it's cessation, main objectives of whole project and the aim of its profit. This hand book should serve primarily to potential future franchise partners – to help them with better orientation in supply of franchise network on the market.¹⁰

¹⁰ CZECH FRANCHISE INSTITUTE [online]. c2009 [cited 2010-09-02]. Available on: <<http://www.ifranchising.cz/franchising.php>>.

Franchise package and manual

Franchise package includes franchisor's business plan which consists largely from franchisor's assistance in setting up a new business (market research), permission to use incorporeal rights, image and goodwill, transfer of know-how through training and consulting and other support in form of acquisition of the territory, sales promotion, supply promotion or responsibility for certain administrative functions. As it was already said, for this assistance franchisor requires some fees, maintenance of image and goodwill, exclusivity of selling products and services as well as independent activities in the market and ability to obtain necessary data and information about business. The part of manual is also management methodology. It is detailed instruction manual about everyday management of franchise business.

Because this hand book is almost detailed guide to success, every franchisor tries to protect it as much as are his possibilities. The manual contains a description of the know-how and other business secrets. For this reason franchisor often gives franchisee access to the manual by the time of pre-contractual proceeding. It is also preferable to describe know-how gradually. Franchisee should receive know-how in parts, so that he will also get the feeling that long-term cooperation with franchisor is important. By the same time franchisor safeguard him/herself from early ending of the cooperation.

The content of each manual should be adjustment of following items: the basic characteristics of franchise concept and its philosophy, than description of franchise establishment and its individual parts, further analysis of business management methods and everyday operation procedures, equipment of business premises, operation time and opening hours, description of accounting standards and franchise fees and payments. Helpful should be also sample forms of employment contracts, material responsibility agreement, agreement about the protection of business secrets, agreements with suppliers, customers and others. Manual should also include address book with links to all members of franchise network. It is important to update

this manual regularly. To create a proper manual is not an easy task. Therefore many companies cooperate with franchise advisers who can help with processing the manual well (Řezníčková, 2004).

System of control questions

Before starting mutual cooperation, it is needful to think about several crucial questions. For franchisee are most frequent: *Do I have business personality? Am I capable to bear the weight of self-employment? Do I have some previous experience with this type of business? What do I know about franchisor and his franchise business? Are his products and services competitive in my area? Do I have needed capital? How am I able to ensure it? Does my investment has a realistic chance of return?*

Not only those but even more questions are usually the content of the questionnaire, which is putted before potential franchisee to complete before starting business cooperation. Very similar questions should ask also franchisor: *What do I require from the franchisee? How is he/she old? What are his/her family circumstances? Does he/she has necessary personal qualities? What is his/her career history like?*

Sometime are these questions and connected issues underestimated. However they should be an important guideline for successful selection of good co-worker for franchise business (Řezníčková, 2004).

Pilot project

Franchise project itself is usually created so that franchisor first set up his own business and consequently he tries to extend it through franchise business. Quiet often it is possible to meet entrepreneurs who are identified as so-called “black sheep”. These entrepreneurs are trying to use uncertified and untested franchising project to obtain financial funds. And also for this reason should be the choice of franchisor well-advised step. Franchisor should try to create a project which is as simple as possible. The pilot project should identify problems and gaps (optimal

opening hours, optimal level of prices, most effective advertisement, etc.). In the frame of pilot running are very often trained workers, who subsequently act as advisors for new franchisees (Řezníčková, 2004).

Legal base of franchising – formation of franchise contract

According to fact that franchising as business activity isn't regulated by Commercial code and is not possible to qualify it as any official business system (there is a mix of characteristics from all systems), it is important to set up the franchise contract properly. The franchise agreement shall comply with the Czech National law, European community law, Code of Ethics and any national Extensions thereto. With respect to slowness and complexity of franchise business implementation, the majority of entrepreneurs conclude during its process two contracts: preliminary one and proper contract (if everything runs according to conception).

In connection with pre-contract agreement European Code of Ethics requires that Before the signing any pre-contract, the franchise candidate should be given written information about its purpose and about payments he may be required to pay to the franchisor to cover actual expenses connected with respect to pre-contract agreement. If the agreement is executed, the above mentioned consideration should be refunded by franchisor or set off against a possible entry fee. The pre-contract shall define its term and include a termination clause. Franchisor can impose non-competition clause and secrecy clauses to protect its know-how and identity.¹¹

The Czech Franchise Association is mentioning essential minimum terms of proper franchise agreement:

¹¹ EUROPEAN FRANCHISE FEDERATION. *European Code of Ethics for Franchising* [online]. 19.9.2008 [cited 2010-08-26]. Available on: <<http://www.eff-franchise.com>>

- The rights granted to the franchisee. That means proper enjoyment of all rights (also rights connected with non-tangible assets), which are pass on franchisee though the franchisee agreement. However their holder is still franchisor.
- Protection against potential disallowed encroachment on franchise network from the third part.
- Detailed description of franchise system, including control mechanisms – either franchisee´s of franchisor´s.
- To ensure franchisees proper business performance based on mutual cooperation.
- Properly adjust all the rights and responsibilities as well as other factors characterizing the franchise concept, so that possible disagreements and consequent damages are avoid.
- The franchise agreement should be in written form to ensure legal certainty of both parties (Czech Franchise Association, 2008).

Above mentioned shows how important is to compose all rights and responsibilities of both parts, as well as payment obligations, description of goods and services, terms of cooperation, conditions of eventual termination, how to use typical symbols, trade mark, service mark, logo or other special identification.

3.4.1. The process of contract settlement

The whole process of contract settlement and initiating franchise cooperation has several stages. The first phase is to find appropriate franchisee. This is done through advertisements, promotion on franchise fairs or other possible ways.

The second phase is communication with potential franchisee, when potential franchisee receives an application form for taking out a license together with information booklet about franchise system, it´s conditions, alternatives, etc. This form also includes some questions about franchisees personal information and

information about his past and current employment, work field, experience, references, etc.

Third phase is evaluation of filled form. In this step are no uniform rules. Every franchisor should evaluate his potential franchise partner by himself. Usually are various questions scored and the sum evaluates potential franchisee.

The fourth part starts if potential franchisee meets franchisors requirement – it is an interview. Through its mean can both parts assess potential cooperation. Important is franchisees experiences, goals, financial possibilities and interest in joining the franchise network. Sometimes is possible to see and try everyday operation in some franchise premise and meet closely with the business. It can significantly help with final decision whether franchisee will join franchise network or not.

The fifth stage is already the conclusion of pre-contract agreement. Its subject is among others a commitment of both parties to conclude proper franchise agreement in at defined term. There are also basic conditions such as participation and successful graduation in the initial training, selection and change-over to uniform appearance of future franchise premises as well as preliminary contract of lease for using the business premises. If the pre-contract agreement is concluded and if specified conditions are met, it is possible to start cooperation between franchisor and franchisee which will result in conclusion of proper franchise agreement (Mendelsohn, 1999).

4. THE USE OF FRANCHISING IN PRACTICE (ANALYTICAL PART)

4.1. Lentil Buffet (basic characteristics and philosophy)

Lentil Buffet is a medium size business company provided by Lentil Ltd. which operates in gastronomic area. It is a kind of eating place offering hot and cold meals in a buffet form. Even it sells ready meals, the term “fast food” isn’t apposite enough to describe it. Therefore this work uses expressions as eating place, buffet of restaurant to define it.

Lentil Buffet has thirteen-year long history and is located in busy part of Prague 1 on the board of historical town. It is a profitable subject with very good economic situation. That’s why its management (owners) would like to extend the business. They want to unify and complete the current way of doing business into a unific system and open a new premise which will serve as a pilot project for potential franchise network. Nowadays when quality and balanced eating diet is more and more underlined, Lentil Buffet management decided to follow that stream. Their primary ambition is to offer such a range of dishes, which meets the requirement of a well-balanced lifestyle. The intent is to provide high quality and healthy dining experience and to be an answer to ever growing number of fast foods.

An important part of management philosophy is to create such background that savours warm and family atmosphere in restaurant. Family atmosphere means kind and helpful attitude of employees, who are willing to complete satisfaction of every customer and to meet their specific request.

4.1.1. Assortment

As mentioned above, Lentil Buffet offers hot and cold meals. Hot meal menu takes bigger part of the whole selection and the restaurant management considers it very important. According to the fact that in actual premise of Lentil Buffet it creates substantial part of revenues, owners pay attention on it and they intent to do the same in newly planned Lentil Buffets. Food which is served must confirm that restaurant sells fresh, healthy dining from high quality ingredients. The management stresses that meals aren't too unhealthy, hampering the body and are prepared from fresh food without artificial additives, preservatives or semifinished ingredients. The assortment of meals can be classified as European cuisine. In Lentil Buffet is possible to find Italian, Hungarian, Balkan, Slovak, Polish, Russian or Czech cuisine. Important is, that dish gives feeling of home made meal and that it is not too complicated for customers (in other words). Meals usually contain a lot of vegetables, however customer can also find the range of classic meals. Examples of foods can be: cabbage musaka with meat, stuffed and grilled eggplant with potatoes, turkey pilav with fresh tomatoes and cheese, Tuscan wholemeal spaghetti with fresh tomatoes and cheese, Slovakian "halusky" with cabbage, sirloin of beef in cream, brown betty with cottage cheese or sweetened lumps of potato puree with poppy seeds.

Assortment of cold cuisine is composed of selected types of typical Czech open sandwiches and salads, there is also a range of light vegetable salads, filled rolls and baguettes. Although the Czech open sandwiches and salads do not match the main idea of offering healthy and light meals, it is a part of Lentil Buffet offer, however it still holds the motto of food freshness and quality. Main reason is that typical delicatessen stores are nowadays rather scarce. Variety of typical open sandwiches includes also healthier and lighter versions on whole wheat bread with more vegetable. Among selection of traditional salads is also possible to find vegetable salads, light salads with yogurt or low-fat cheese. Typical open sandwiches and Czech salads are very often an attraction for tourists, however it's possible to find its fans also among Czech clients. A

larger number of open sandwiches or salad plates can be purchased on order, which is mainly done for parties or social events. Pastry is supplied from the family bakery, which assures owner's requirements for quality and long-term freshness. Baguettes, rolls and salads are strictly controlled so that are not conned on fillings or vegetable. Cold assortment includes also homemade pies. Its offer is limited to a maximum of two kinds for a day. Examples of cold assortment can be vegetable salad with yogurt and cheese, carrot salad with pineapple, traditional Old Czech potato salad, salad from "Hana", Mexican salad, ham sandwich with egg, vegetarian sandwich, sandwich with tomatoes, filled roll with ham and cheese, Greek salad, tuna salad and others.

4.1.2. Competition

Taking in consider above mentioned range of dishes assortment, competitors of Lentil Buffet can be divided into two main groups – those who offer hot meals and those who sale assortment of cold cuisine.

For Lentil Buffet is competitor every catering facility, which provides "quick ordered" meals in similar price range. That are not only fast food type restaurants, bus also restaurants with lunch menus. Traditional fast foods can be also seen as a kind of competition.

Concerning cold cuisine, competitors are all establishments offering typical Czech open sandwiches and salads, than bakeries which offer filled rolls, baguettes and pastries and also all those who offer fresh vegetable salads

4.1.3. Customers

As indicated above, the restaurant is destined for customers from neighboring surrounding as well as passing clients. Target segments of Lentil Buffet are mainly people working in surrounding offices, shops or schools, than customers who live near the restaurant, occasionally passer-by clients and also tourists, both national and from abroad. Current restaurant is located in busy part of town and management of Lentil Buffet would like to keep similar kind of locations also for its future premises. Customers working around take their meals mainly over lunch time, especially when using either option of favored lunch menus or if they just come in to buy some small snack from selection of salads, baguettes, rolls and typical Czech open sandwiches. There are also construction workers who visit the restaurant. They often buy lunch menus, take away snacks. Local residents mostly choose from range of cold dishes (e.g. open sandwiches and salads for family celebrations or friend's visit). Local residents are also seniors. They like to sit down at a small sandwich or dessert with coffee. It is quiet surprising that they often buy lunch menu.

Tourists are mostly from Poland, Hungary, Spain, Germany, Russia and Slovakia. It is often a small group of young people who are either interested in Czech cuisine and Czech classic salads and open sandwiches or just want to eat at reasonable prices.

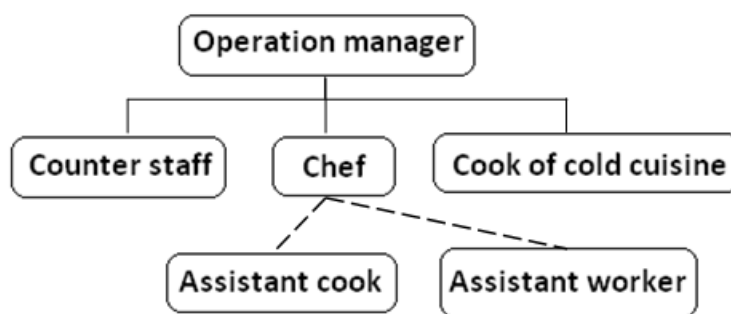
Assortment of dishes is suitable also for families with children or suppliers of surrounding businesses who visit the area of Lentil Buffet. Overall, the scale of Lentil Buffet customers is composed of wide age range.

4.1.4. Employees

For human resources management Lentil Buffet uses functional structure, which precisely defines hierarchical subordination with clear definition of labour division.

The illustration bellow shows organisational structure of Lentil Buffet.

Illustration 3: Organizational structure



Source: Own processing

Operation manager is on the top of organizational pyramid and all personnel is subordinated to him/her. According to the small size of planned restaurant, it would be franchisee by him/herself, who would hold this function. The responsibility of operation manager is fluent running or the restaurant and satisfied customers. He/she cooperates and communicates with all business partners and the public. He/she is the main person, who deals with complaints and claims. He/she controls procedures in restaurant in accordance with relevant laws and other common mandatory regulations. Because operational manager is franchisee him/herself, his/her responsibility is also wage policy and its conditions.

There are two persons as counter staff. Counter staff is responsible for serving customers and sale of food. They watch to meet all customer requirements completely, fast and in time. They should take care about correct serving meals. They control quality of the food, which is also a feedback to cooks. Counter staff is

responsible for overall look and exposure of meals in counters. They also accept orders on cold assortment and then they devolve it to cold cuisine cook.

The main task of chef is to complete and prepare a range of offered meals and lunch menus for every day. His/her responsibility are fresh and well prepared meals in accordance with prescribed recipes. Chef supervises organization and good running in kitchen of warm dishes and he also watch over hygiene regulations and safety standards. He/she should be able to spread his/her work during the whole day conformity with equal meal offer corresponding day time. Moreover the selection of meals should be varied. The customer should be able to choose from. Chef of kitchen is responsible for food-supply. In every moment, there must be sufficient amount of necessary base material, however not to excess to spoil food unnecessarily. From organizational structure is obvious his superiority over assistant cook and assistant worker. Assistant cook is at chef's disposal to ensure fluent running of the kitchen. He/she helps with completing menus and in occasion of chef's absence assistant cook should be able to supply him/her adequately.

Assistant worker is available to cooks of warm kitchen and respects their directions. He/she helps with basic preparation of crude food. Assistant worker is also responsible for all-day cleanness of production and sales parts of Lentil Buffet.

Cook of cold cuisine produces the whole range of cold assortment – in accordance with prescribed recipes and weights. He/she completes everyday cold assortment offer corresponding day time and actual demand. He/she oversees the amount of necessary food material and its supply transacts with chef. Cook of cold cuisine is also responsible for order fulfilment. During his/her work he/she should keep all hygiene regulations. Accounting and possible legal services are outsourced.

The management of Lentil Buffet requires specific working skills for some positions. Its summary is shown in table below.

Table 1: Working skill requirements

Position (number of employees)	Education	Work experience
Operational manager (1)	High school + leaving examination	Minimally 3 years in gastronomy (with leaving examination). Minimally 5 years in gastronomy (without leaving examination).
Counter staff (2)	Skilled worker	Minimally 1 year
Cooks (3)	Skilled worker	Minimally 1 year

Source: Lentil Ltd. internal data

For future franchise business, separate staff training seminar won't be necessary. The staff will be trained during the recruitment process. This process will include entrance selection procedure which will proceed in form of personal interviews and consequently by half day practical workout directly in the running of Lentil Buffet.

The situation will be different at the position of operation manager, who will be the franchisee him/herself. Operation manager should be well trained off course.

4.1.5. Sales system

Hot dishes are intended for immediate sale. They are exposed in warm counters, so that every customer can simply choose from ready meals offer and does not have to wait until his/her food is prepared, as it is in traditional restaurants. Cold assortment is exposed in refrigerated counters. It is also possible to order larger amount in advance. All meals are take away.

Initial staff training includes also sales system. Counter staff have prescribed procedures how to offer and sale meals. Maybe it seems silly, but those procedures are very efficient for customer satisfaction and growth of sales. Meals should be always offered with salad and drink, it is important to draw customer's attention to dessert, soup is always offered with bread. Than is important to know, if customer

wants to eat in buffet or to take meal away. Every dish has characteristic way of serving on plate (it ensures correct weight/amount of meal and also required appearance of food). Staff of cold cuisine has exactly prescribed procedures for production, decorating and exposure of various products.

4.1.6. Estimation of consumer demand

Management of Lentil Buffet defines consumer demand in three main cycles: daily, week and year, those cycles influence actual splitting of customer segments. In new restaurant is supposed that seasonality as well as cyclicity will be very similar to current Lentil Buffet. The supply of meals is adapted to respective cycles. Characteristics of these cycles can be different for each premise depending on surrounding conditions (e.g. attractive tourist area, office area, etc.).

Majority of cycles is influenced by seasonality. In current restaurant is possible to observe decrease in sales mainly in summer and winter months. The summer season is typical for holidays when lot of clients (mainly from offices) are away and unfriendly weather of winter months makes people to stay in their office and eat just something quick brought from home.

Considering daily cycle morning is important for cold cuisine assortment while during lunch time is necessary to focus on warm dishes and lunch menus, which realized most of the daily sales.

If taken in account weekly cycle, the volume of sales increases from Monday to mid-week and with upcoming weekend falls. With respect to the fact, that volume of sales depends mainly on clients from surrounding offices, is current Lentil Buffet open only during working days. Weekend running won't be financially efficient. Therefore in newly planned restaurant is not yet calculated with weekend running. The practice will show, which customer will visit the establishment.

4.1.7. Marketing strategy

The marketing strategy of Lentil Buffet means three basic aspects: the atmosphere of the restaurant, the way of providing services and the product quality.

The atmosphere of restaurant should breathe out family, warm and kind atmosphere. Interior should leave a fresh, airy, clean and bright feeling. This atmosphere also promotes unification of restaurants to light spring green and red colours.

The way of providing services is in responsibility of the personnel. It is mainly counter staff, who is in touch with customer. Therefore the management of Lentil Buffet employs such people, who know how to be kind, helpful, positive, powerful and decent. Good communication skills are also very important. Customer should be aware that is on place, where he/she will meet friendly, initiative and open attitude staff who will do everything possible to meet his/her specific needs.

Unified product quality is what makes or helps business network to be franchise network. Lentil Buffet wants to offer the finest fresh meals from quality food and ingredients, which are lightly digested, without artificial additives and preservatives, tasty and also appealing to the eye.

Actual business environment requires to know who is your customer, to define your customer segments, to be aware what are its needs and then on the basis of this knowledge to create and prepare the product. This procedure is typical also for Lentil Buffet management. Important part of marketing is also sales promotion and the most effective use of its tools.

The rule is that the price for product and services is set at a minimum level of costs size, it should also include a reasonable profit as a reward for entrepreneur. The customer usually measures the price to the quality and quantity of the product obtained. This relation determines, if he/she is willing to pay for the product or not. The product must meet his/her expectations. Lentil's Buffet assortment is destined for general public, which means that price level is set at medium level. Sale margin for meals is set at 200%, margin on beer and non-alcoholic drinks is about 100%. For larger

orders of cold cuisine assortment the price is set individually depending on the nature of particular order.

Current restaurant does not use any system of loyalty rebates, however, in new Lentil Buffets the management would like to establish them. It plans to make a system of collecting point for each meal over 150 CZK. When customer reaches 15 point, he/she will get a free lunch.

4.1.8. Interior design

The interior of the restaurant will be designed so that customer could feel family and warm atmosphere realized that is on place where he/she can get meals following the philosophy of healthy lifestyle. Therefore restaurants should leave a fresh airy feeling. Lentil Buffet colours are spring green in combination with red. Based on franchise principles, Lentil Buffets should have a uniform appearance of all facilities. That means colours of restaurants, equipment and furniture, the way of presentation, meal offer (offer chart boards, sample photos of meals), the way of cold and warm dishes exposure, table ware has same colour in all restaurants, etc. Important part of design is also the logo of company, which must be presented consistently. It will be on shop windows, offer chart boards, staff uniforms (aprons and jackets) and bags.

All proposals for interior design should be consulted with the franchise owner of Lentil Buffet.

4.1.9. Sales promotion

For Lentil buffet, sales promotion can be divided into local and general advertisement. General advertisement is in responsibility of franchisor. Local promotion will be provided by the franchisee him/herself on his/her own costs. Sale promotion channels will be web site, local newspapers, leaflets, radio, but also offer chart boards in front of

the restaurant. General promotion will be primarily through web site, on which each restaurant will have its own site for actual update of daily meal offer and lunch menus. The part of franchise cooperation will be statutory reserve fond for advertisement, which will be some amount given to franchisor for general promotion and rest will remain to franchisee for local advertisement.

4.1.10. Suppliers

The range of suppliers cooperating with franchise network ensures consistency of sold products. With respect to previous experiences the company Lentil Ltd. wants to continue in cooperation with same suppliers as today. Those suppliers are Nowaco, Makro, Tchibo or Coca-Cola. Among more specific are private meat and eggs suppliers from Czech farms and family bakery Janousek. The management prefer them due to the quality and Czech origin of their products. Company providing printing on cloth, plates, boards and bags will be also the same for all restaurants.

In cooperation with Plzenksy Prazdroj and Coca-Cola companies will be agreed annual grant fee for sold amount of beer and non-alcoholic beverages. This financial grant will fall to franchisees share and it will depend only on his/her decision how it will be used. With other suppliers will be agreed exclusive large-scale buying for whole franchise network, which should ensure better price conditions for franchisees.

4.1.11. Lentil Ltd. as a franchisor

Future body granting the franchise license would be the company Lentil Ltd., which would implement a gastronomic franchise network under the name Lentil Buffet. In addition to the obligations, which will save the franchise agreement, plans Lentil Ltd. to provide and consult following additional services (in cooperation with future franchisor):

- classification of premises for future business
- business plan development
- consultation of architectural rendering
- manufacture and installation of interior
- advice on the necessary financial resources for initial investment
- financial support (e.g. leasing for interiors, financial contribution for advertisement given from suppliers, etc.)
- attractive price from suppliers
- provision of system information for pecuniary interest
- training

As a franchisor Lentil Ltd. should become a member of the Czech Franchise Association (CFA) and thereby confirm a solid business intendment and gain respectability. Membership in CFA itself is the guarantee that the licensor complies with Czech and international standards. CFA is a member of the European Franchise Federation (EFF).

4.1.12. Cooperation process between franchisor and franchisee

The following chapter describes an eventual cooperation establishment between franchisor and franchisee within the potential franchise network Lentil Buffet. The whole process is divided into several steps and suggested procedure uses practical experiences of current company owner and is also based on theoretical background.

In practice it is an eventual franchisee (candidate for franchise licence) who makes the first step to mutual cooperation through contacting particular franchisor and it won't be different for Lentil Buffet. At this point the candidate should obtain general information. Franchisee should come up with an offer of some commercial space suitable for future restaurant. This is related to the second step, in which offered premises will be classified by management of Lentil Ltd. and its suppliers and in case of

positive evaluation, this step will be completed by conclusion of an agreement on offered space evaluation. According to experiences from present restaurant, basic conditions for premises are:

- position (pedestrian zone, important sights, town centre, office areas, shopping areas, major travel routes, conditions for supply, etc.)
- competitors
- suitability (with regard to hygiene regulations for kitchen and sale premises)
- capacity (optimal to location)
- other (e.g. space ownership or duration and amount of the lease)

In the third step should be assessed future entrepreneur, his capabilities and qualities. Applicant for a license should have his/her own financial capital. From the experience of current business owners, the optimal structure of financial sources proved to be minimally 30% of own sources and 70% of external financial sources from total capital. The candidate should also have above mentioned disposable commercial space.

If premises and candidate meet all requirements, than can Lentil Ltd. elaborate its business offer. This draft would include design of interior and specification of strategic partners support. For consideration will be calculated a detailed business plan. Than the candidate will be familiarized with agreement entitling to use the Lentil Buffet business concept. The contract will cover conditions, rights and obligations of mutual cooperation.

Necessary adjustments of premises would be in responsibility of Lentil Ltd., which would ensure source materials for designer or hand workers. Alternatively (on the wish of franchisee) it could ensure whole construction work from external firm.

In the event of smooth continuance and candidate's consent with all parts of the contract, would come to sing up of the first part of the franchise contract. It would be a Contract for work - to ensure the delivery of Lentil Buffet interior. Along with signing the contract, the candidate would remunerate entrance fee of 100 000 CZK. This fee is

a usual part of franchise business cooperation and it reflects the seriousness of candidate's interest.

After signing the contract, the company Lentil Ltd. would provide architectural rendering, design documentation and basic adjustment of premises. After consulting would be defined and chosen final version of future restaurant and also set the final price. Then would follow realization itself – manufacture and installation of interior components and kitchen and sale premises equipment. In order of keeping project complexity, above mentioned activities as well as the implementation of an advertising device and an external shop sign would be provided by Lentil Ltd. Company Lentil Ltd. would also ensure the delivery of information system. During adapting of premises would occur the training of future operation manager (franchisee him/herself) and staff recruitment.

In the event that the reconstruction was completed and the entrepreneur would be ready to open Lentil Buffet, there would be a signing of the second part of franchise agreement granting the right to use the concept Lentil Buffet.

4.2. Financial and economic solution

4.2.1. Actual business performance

Analysis of current business activity is important to demonstrate that the business concept Lentil Buffet is able to be prosperous and profitable in long term period. Therefore, for purposes of this thesis, have been calculated a financial analysis of current Lentil Ltd. enterprise. The analysis covers last three years of operation, namely 2008, 2009 and 2010. Data for calculations are related to financial and tax record documents, which were obtained from internal sources of the company. Lentil Ltd. uses tax record of entrepreneurs. In comparison with common economic reports of larger companies, tax record data are limited. That's why was sometimes rather complicated to use it for standard indicators of financial analysis. In those cases, to avoid incorrectness of outcome results, calculations have been done after consultation with Lentil Ltd. management.

4.2.1.1. Expenditures

Table number 2 specifies in detail company's expenses in 2008. It is possible to divide them into several main sections – working expenditures, operational expenditures, wages, employee's insurance and purchase of goods. Further sheet summarises expenditures also for 2009 and 2010.

Table 2: Expenditure in 2008

Expenditure	2008
Working expenditures	
Electricity	131 228
Gas	5 860
Water + other services	68 659
Rent	540 000
Bank charges	3 694
Company insurance	16 143
Car insurance	5210
Car maintenance and fuel	40 380
Business premises maintenance	2 170
Other overheads	12 094
Subtotal	836 675
Operating expenditures	
Operating material	53 650
Other operating expenditures	21 674
Subtotal	71 000
Wages (number of employees)	
Operation manager (1)	216 000
Chef (1)	192 000
Cold cuisine cook (1)	192 000
Assistant cook (1)	168 000
Counter staff (2)	336 000
Assistant worker (1)	144 000
Subtotal	1 248 000
Employee's insurance	561 600
Purchase of goods	
Food	1 450 000
Beverages	480 000
Subtotal	1 930 000
Total expenditures per year (CZK)	4 576 275

Source: Lentil Ltd. Internal data

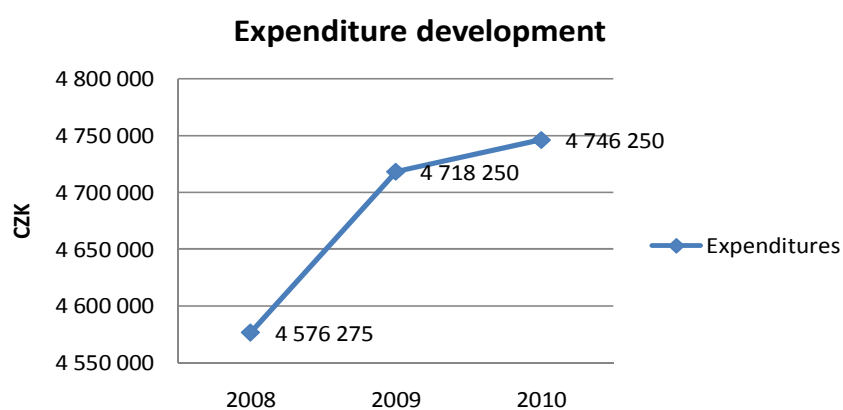
The following table compares expenditures between years 2008 and 2010. Expenditures are obviously every year slightly higher, however the rate of increase is declining. This fact highlights also stated percentage change.

Table 3: Expenditure development

Expenditure development			
	2008	2009	2010
Working expenditures	836 675	840 000	842 000
Operating expenditures	71 000	60 500	58 500
Wages	1 248 000	1 255 500	1 258 500
Employee´s insurance	561 600	572 250	582 250
Purchase of goods	1 930 000	1 990 000	2 005 000
Change %		3	0,6
Total (CZK)	4 576 275	4 718 250	4 746 250

Source: Lentil Ltd. internal data

Graph 1: Expenditure development



Source: Own processing

4.2.1.2. Income

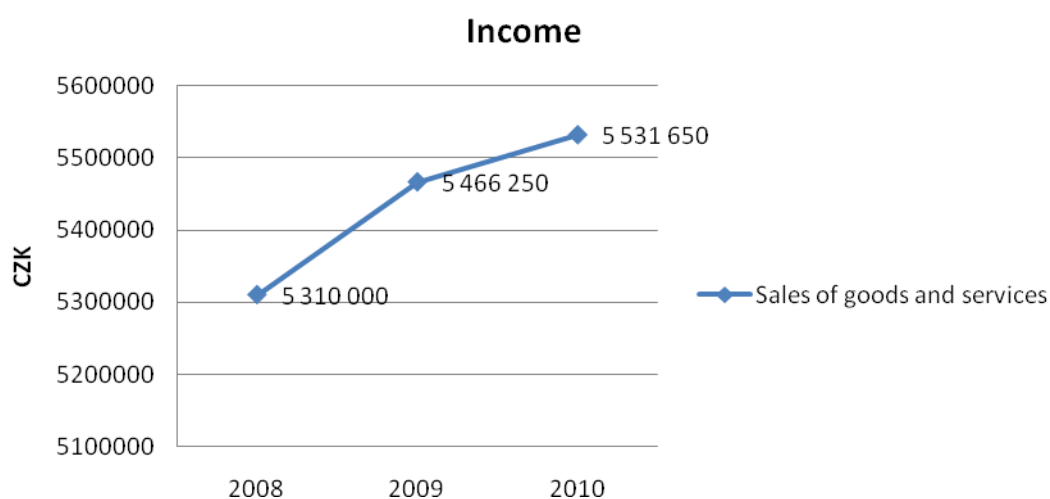
To the following table should be noted that it does not confuse terms of revenues and incomes, but that for analysed company these terms coincide. Lentil Ltd. uses tax record system. Due to the nature of Lentil Ltd. enterprise running are sales of goods and services income as well as revenue. From table 4 as well as from graph 2 is clear, that Lentil Buffet income is still growing year on year. Between 2009 and 2010 is the rate of growth lower, which could be partly a reflection of global economic crisis. On the other hand it can be also an evidence of need to enlarge the capacity of business and use its potential.

Table 4: Enterprise income

Income			
	2008	2009	2010
Sales of goods and services	5 310 000	5 466 250	5 531 650
Change (%)		3	1.2
Total (CZK)	5 310 000	5 466 250	5 531 650

Source: Lentil Ltd. internal data

Graph 2: Income development



Source: Own processing

4.2.1.3. Profit and loss calculation

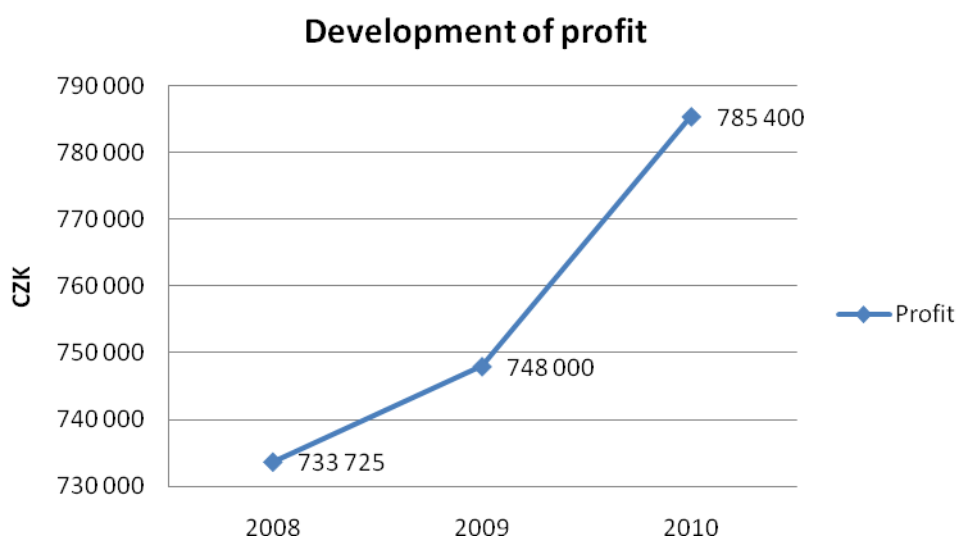
The last part of the current business evaluation is profit or loss identification. According to calculation of data mentioned above and other Lentil Ltd. internal data, it can be said, that last three years the company have had a positive business performance. Percentage comparison shows that second year profit has been even higher. It is possible to observe a 5% increase between 2009 and 2010 compared to previous year. Data are shown graphically as well.

Table 5: Profit and loss calculation

	2008	2009	2010
Total incomes	5 310 000	5 466 250	5 531 650
Total expenditures	4 576 275	4 718 250	4 746 250
Profit/loss	733 725	748 000	785 400
Change %		2	5

Source: Lentil Ltd. internal data

Graph 3: Development profit



Source: Own processing

4.2.2. Financial plan and analysis of future Lentil Buffet

This chapter describes financial plan for pilot premise of new Lentil Buffet. It is worked out with regard to possible directing by franchisee. The financial planning takes in consider a largeness of future establishment and a size of expected demand. After consultation with Lentil Buffet management, the financial plan is calculated in slightly optimistic version according to expected demand. Expected demand is estimated at 75%, which influences also estimated costs (especially the variable component) and revenue. To compare it, calculation also includes the theoretical value of 100% expected demand. For better clarification, following table contains data specifying parameters of future Lentil Buffet and values which are a part of other important calculations. Their size was determined by Lentil Buffet management based on years of experience. An important value is number of customers for one seat per one day for 75% and 100% of the estimated demand. Significant are also costs, which vary for both different sizes of demand.

Table 6: Parameters of future restaurant

Size of demand:	75%	100% (if differ)
Size of premises (m ²)	170	
Location	Prague 1, New Town	
Rent/month (CZK)	50 000	
Number of seats	70	
Number of open days per month	22	
Number of open days per year	264	
Food margin	200%	
Drink margin	100%	
Depreciation	linear	
Expected spending of customer/day (CZK)	100	
Number of customer per seat per day	3	4
Expected revenue per 1 seat (CZK)	300	400
Total amount of customers per day	210	280
Total amount of customers per year	55 440	73 920
Total costs (CZK)	5 205 128	5 861 661
Variable costs (CZK)	1 969 000	2 625 533
Fixed costs (CZK)	3 236 128	

Source: Lentil Ltd. internal data, own calculation

4.2.2.1. Covering resources

Current proposal of franchise project takes in account the fact, that investments contributed by franchisee to the future facility would be not only from his/her own sources, but also from some external source of financing, more probably a bank loan. In such a case would then be required a minimum level for the amount of own financial capital. This minimal level would be 30% of total investment costs. This ratio is based on estimation of current Lentil Buffet owners arising from practical experiences. The following table contains a more detailed specification of covering sources, its amount and percentage proportion on investment costs (resulting from internal data and calculations of Lentil Ltd.). Bellow is schedule of the loan which is based on current UniCredit Bank offer.

Table 7: Covering resources

Covering sources	Amount	Share on total amount (%)
Own	350 000	30
External – bank loan	750 000	70
Total (CZK)	1 100 000	

Source: Own calculation

Table 8: Loan schedule

Loan schedule (CZK)	
Loan	750 000
Interest rate	12.55%
Number of months of repayment	60
Monthly payment	16 893
Monthly insurance of the loan	1 051
Total monthly payment	17 944

Source: UNICREDIT BANK CZECH REPUBLIC, <http://www.unicreditbank.cz/cz/podnikatele/uvery.html>

4.2.2.2. Expected Costs

Investment costs

For business in catering services is typical large portion of initial fixed costs. Investment costs consist primarily of kitchen and sale premises facilities and equipment. Stated level of various costs respects expert estimates of Lentil Ltd. and current prices on actual market with gastro equipment – Matthes Gastro Equipment, to be specific. For size of future Lentil Buffet, investment costs were estimated at 1 100 000 CZK. Investment costs include also initial franchise fee of 100 000 CZK. This fee would pay a future franchisee to owner of franchise network (current owners of Lentil Buffet). Further table summarise needful investment costs for opening new Lentil Buffet. Investment costs consist primarily of kitchen and sale premises facilities and equipment. Stated level of various costs respects estimates of Lentil Ltd. and current prices on actual market with gastro equipment.

Table 9: Presumed investment costs

Investment costs	
Kitchen equipment	600 000
Kitchen facilities	30 000
Sale premises equipment	250 000
Sale premises facilities	80 000
Cash + software + printer	40 000
Initial franchise fee	100 000
Total (CZK)	1 100 000

Source: MATTHES, <http://www.matthes.cz/>, own calculation

Expenditures

Calculation in table number 10 shows detailed breakdown of estimated expenditures per one year. The data is based on the assumption of 75% demand. Expenditures are compared with last analyzed year (2010) of current restaurant. Amounts are determined on the basis of Lentil Ltd. estimation, in order to be actual, realistic and applicable for opening of new Lentil Buffet establishment.

General operating costs and operating expenditures are higher by 8% and 3%, however is certain clear that employees' wages are lower. The reason is to have a reserve for pay rise in the future. Itemized wage costs are predicted in table number 11. Purchase of goods includes expenditures for food and beverages. Another item of operating costs would be a regular fee for the use of Lentil Buffet franchise concept calculated from month turnover. This fee was set at 5% from month sales.

Table 10: Expected expenditures per year

Expenditure	Change (%) (compared to 2010)	Expenditure for 75% demand
Working expenditures	8	910 000
Operational expenditures	3	60 000
Wages	-1	1 248 000
Employee's insurance	-1.5	561 600
Loan payment		215 328
Annual franchise fee		220 000
Purchase of goods		1 990 000
Total (CZK)		5 205 128

Source: Own calculation

The basis for determination of wage costs is the number of workers and their wages. Number of workers of course depends on the size of new buffet. This project calculates with the amount of seven full-time workers. As stated above, the calculation is carried out at 75% demand, which are 210 customers per day. Operation manager is

franchisee him/herself, that's why this working position has so low wage, although it is at the top of organisational pyramid. In the following table is possible to see all wages separately.

Table 11: Wage costs

Wage costs (CZK)	
Operational manager	18 000
Chef	16 000
Cold cuisine cook	16 000
Assistant cook	14 000
Seller	14 000
Seller	14 000
Assistant worker	12 000
Total wage costs per month	104 000
Total wage costs per year	1 248 000

Source: Own calculation

Depreciation

For kitchen and sale premises equipment and facilities will Lentil Ltd. use linear depreciation method. First year with rate of 5.5% and following 9 years with 10.5%.

4.2.2.3. Expected revenues

Expected revenues are calculated in two variants of 75% and 100% demand. Revenues of buffet are create mainly from sales of products and services. More realistic version of 75% demand expects 3 guests per one seat and one day with average spending of 100 CZK per one customer. Following table illustrates expected revenues in detail.

Table 12: Expected revenues per year

Expected revenue	75% demand	100% demand
Number of guests per one seat	3	4
Total amount of customers per day	210	280
Expected spending of customer/day	100	100
Expected spending of customer/day	21 000	28 000
Expected revenue per month	462 000	616 000
Total (CZK)	5 544 000	7 392 000

Source: Own calculation

4.2.2.4. Projected profit and loss calculation

Undermentioned table summarizes expected profit of future Lentil Buffet at level of 75% demand. For comparison, table also includes values for 100% demand. Revenues are calculated from number of customer per one seat per one day, which vary for different level of demand. Costs are different for each level of demand as well. Variable costs increase with the increasing rate of demand, which reflects total costs.

Table 13: Profit calculation

Profit calculation	75% demand	100% demand
Expected revenues	5 544 000	7 392 000
Expected costs	5 205 128	5 861 661
Profit (CZK)	338 872	1 530 339

Source: Own calculation

4.2.2.5. Break-even point analysis

Break-even point is the point at which is company's profit equal to zero. For Lentil Buffet is essential to determine the number of customers at which the restaurant is not lossmaking neither profitable. Therefore it is minimum number of customer over which restaurant is able to realize profit.

For the purposes of this analyses is necessary to divide costs on variable and fixed one. Fixed costs do not change with the volume of production, with variable costs it is contrariwise. For restaurant enterprises variable costs are mainly composed of basic food for meals. Part of variable costs is also consumed energy and in some cases direct wage costs as well. Variable costs per customer are defined as the ratio between total annual variable costs and total number of customers per year at 100% demand. The actual amount of variable and fixed costs for planned facility of Lentil Buffet is shown in table 6.

Another value necessary to know is the unit cost of production. In this project it means sale revenue per one customer. With regard to spending of one guest, the analysis is calculated in two variants, for 100 CZK and consequently for 90 CZK spending of one customer. **Break-even point is then calculated as** (Nickels, McHugh, 1999):

$$QBP = FC / (P - VC)$$

Where is:

QBP	number of customer at breakeven point
FC	Fixed cost
P	sale revenue per one customer
VC	Variable cost per one customer

Outcome of break-even point analysis is number of 50 565 guests per year, thus 68% of maximum demand, which is needed to balance costs and revenues of the restaurant. As has been mentioned several times, the project is calculated on the

estimated size of 75% demand (3 guests per seat per one day) and break-even point analysis shows that the restaurant may begin to generate profits over 68% of maximum demand (if average spending of guest will be 100 CZK). This creates a reserve for potential problems and initial ineffectuality of the project. It is evident that proposed plan has reserves to ensure its viability.

If average spending of guest decrease from planned 100 CZK to 90 CZK, it would need minimally 59 928 guests per year (81% of maximum visit rate). Profit is zero again at this level. These values are not nearly as positive as the first case. However, 90 CZK spending of one customer was estimated as pessimistic variant from the beginning and despite it, there is still some reserve. Based on Lentil Ltd. management experience, spending of one customer is in average 100 CZK. Table below summarizes the calculation clearer.

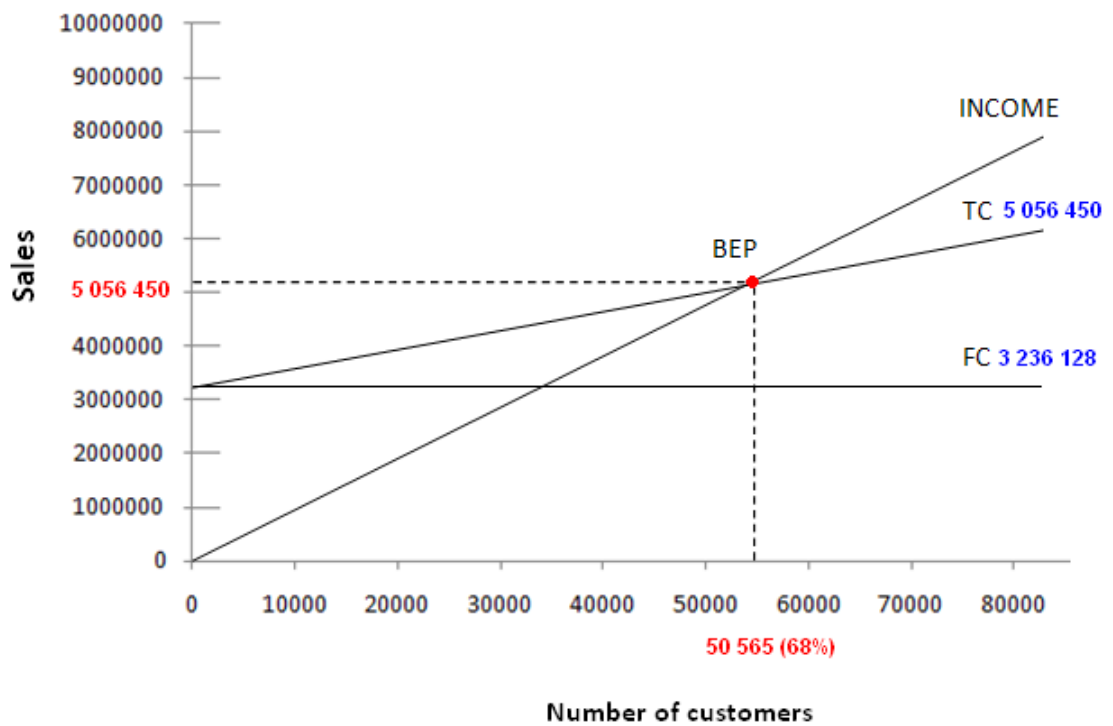
Table 14: Break-even point analysis

Sale revenue per one customer (CZK)	Number of customer at breakeven point/year	Size of demand (%)
100	50 565	68
90	59 928	81

Source: Own calculation

Following illustrations show break-even point in graphic form. First one reflects break-even point at expected spending of 100 CZK per one guest. This point is 50 565 customers. Annual revenues at this number of customers would be 5 056 450 CZK, which would exactly cover needed total costs.

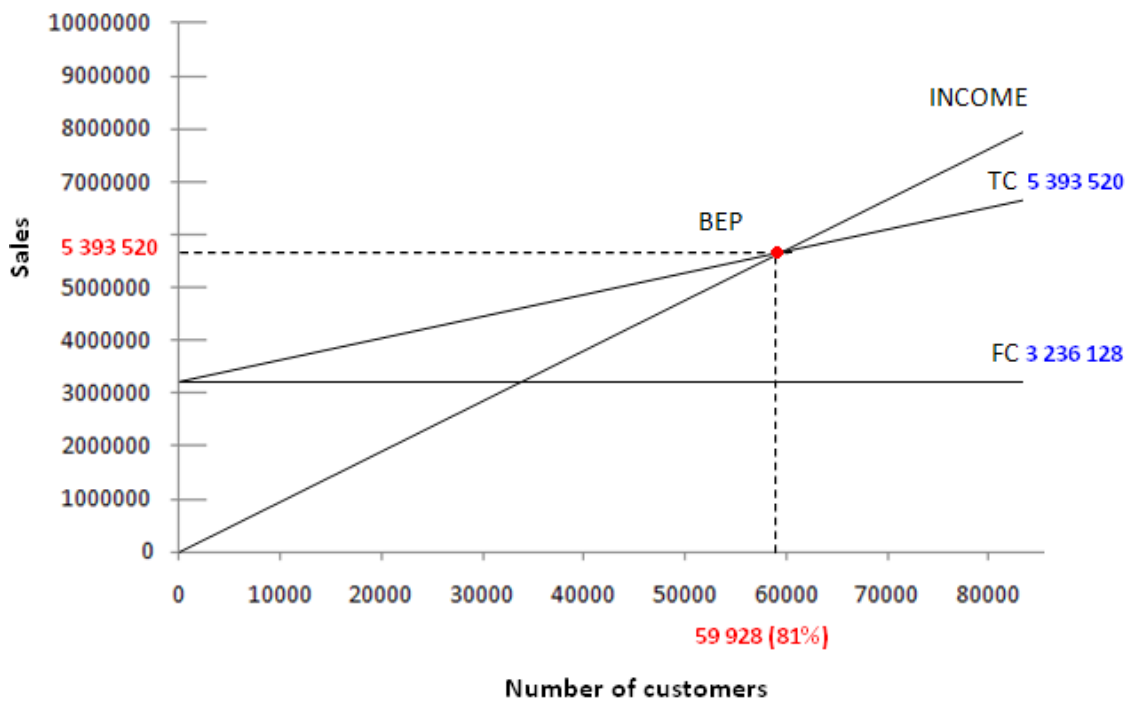
Illustration 4: Break even point for 100 CZK spending



Source: Own processing

Second graph is not so optimistic and expects spending of 90 CZK per one guest. Number of customer at the break-even point logically increases to 59 928 customer per year. To cover needed total costs and make zero profit, annual revenues should be 5 393 520 CZK. Fixed costs are same in both cases: 3 236 128 CZK.

Illustration 5: Break even point for 90 CZK spending



Source: Own processing

5. CONCLUSION

The aim of this diploma thesis was to analyse the topic of franchising business and its use in practice. It processes the possibility of chosen company expand on the market and open new business premise. The purpose of this premise is to serve as a franchise pilot project which would verify whether is existing business system able to successfully expand on the market and be viable in long-term period. Pilot premise is a first step to future franchise network, controlled by Lentil Ltd. Therefore this diploma thesis has tried to unify and complete company current way of doing business, so that it could be a unific and complex business system. Important point of this thesis was to verify if expansion of Lentil Ltd. on the franchising form of business could be a feasible, successful and profitable project in economic and business way. An inseparable part of this process was to analyse company existing economic situation and performance and get data which made a basis for realistic and well-founded results needed for calculation of future premise. According to calculations which have been done, the company have had a positive business performance last three years. Its profit has increased even despite economic crisis.

Second half of practical part has been focused on financial calculation and costingness of pilot project. The financial plan has been calculated in slightly optimistic version according to expected demand, which has been estimated at 75%. Consequently it has assessed its economical effectiveness through Break-even point analysis. Break-even analysis has been calculated in two versions with regard to spending of one guest per one day: 100 CZK and 90 CZK spending per customer. In first case the outcome of break-even point analyses has been the number of 50 565 per year, which is 68% of maximum demand. As has been mentioned above, the project has been calculated on the estimated size of 75% demand and break-even point analysis shows, that the restaurant may begin to generate profit over 68%. This is makes a reserve for potential problems and initial ineffectuality. It apparent that proposed plan has reserves to

ensure its viability. In the second less optimistic variant, when spending of guest is 90 CZK, the Lentil Buffet would need minimally 59 928 guests per year (81% of maximum demand) to be able to start making profit. These values are not nearly as positive as the first case. However, 90 CZK spending of one customer was estimated as pessimistic variant from the beginning, according to Lentil Ltd. management experience, average spending of one their customer is rarely lower than 100 CZK.

Generally speaking, results have shown that Lentil Buffet is a profitable subject with very good economic situation and that it has potential to be prosperous in long-term period.

Integral component of practical part has been concept unification of existing business. This process has signified that Lentil Buffet is capable to perform well as a unified system.

Based on outcomes of this work, it is possible to claim that expansion of Lentil Ltd. on the franchising form of business could be feasible, successful and profitable project in economic and business point of view. Hence it is perceptible, that the form of franchise network is beneficial and effective way how to extend business.

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