

# “Franchising as an entrepreneurial tool in Croatia”

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## SECTION 1. Macroeconomic processes and regional economies management

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### Franchising as an entrepreneurial tool in Croatia

#### Abstract

Franchising is an important means of entrepreneurship, especially in the developed markets. Franchising may provide the same opportunities in developing countries. The level of economic power, as well as the level of franchising, places Croatia among developing countries. Franchising in Croatia has not yet reached its saturation level, which is surprising because the three factors relevant for the franchise sales growth on a macro level (high unemployment, turbulent stock market and change in financing/loans conditions) are present. A wide range of investment categories makes franchising favorable to the prospective entrepreneurs who can afford entry into the world of franchising. The franchises can be found in different business sectors which also makes them suitable for different type of investors and entrepreneurs. Franchisee satisfaction is one of the most important factors of the franchise's long-term success, which implies that the franchisor's service quality towards franchisee must be at its highest level; otherwise overall business success can be jeopardized.

The goal of this paper is to examine the relationship between the franchisor and franchisee and its effect on the level of success of franchisee's business and the suitability of franchise as an entrepreneurial tool in Croatia. In addition to empirical research findings that explore franchisees in Croatia, the authors tried to identify main challenges for research of this topic in the future.

The contribution of this paper is reflected in the following conclusions: the majority of active franchises in Croatia belong to a low cost/investment category. The franchise "popularity" in Croatia according to the type of sector/business doesn't follow the representative trend in developed countries. And finally, franchisees' business success is only partially related to their satisfaction with the service quality level provided by the franchisor.

**Keywords:** franchise, Croatia, relationship marketing.

**JEL Classification:** M13, M21, M31.

#### Introduction

**Franchising as a global phenomenon.** On the global level the franchising business has been increasing by approximately 10 percent annually, in the period from 2004 to 2009 (Foley, 2009) and is one of the most frequently used strategies in expanding to foreign markets. Business sectors which tend to have the largest number of franchises include fast food, real estate, clothing, rent-a-car, hotels, fitness programs and cleaning services.

In a franchising system, individual franchisees are a tightly connected group of enterprising individuals whose systematic operations are planned, directed, and controlled by the operation's innovator, called a franchisor. According to Kotler and Keller (2006) franchises are distinguished by three characteristics: the franchisor owns a trade or service mark and licenses it to franchisees in return for royalty payments, franchisees pay for the right to be part of the system, and the franchisor provides its franchisees with a system for doing business.

Franchising might be defined as a distribution channel structure intended to convince end-users that they are buying from a vertically integrated manu-

facturer when, in fact, they may be buying from a separately owned company (Coughlan et al., 2006). The contribution of the franchisor in the franchise partnership model offers of a well-known product/brand and a successful business concept, while the franchisee contributes managerial expertise, local market knowledge and capital (Oxenfeldt & Kelly, 1969). Franchisees can more easily enter the market, reducing business risk, while purchasing practically confirmed know-how and a well-known brand, right from the start-up level. Franchising makes a great chance for entrepreneurs that try to avoid making mistakes, followed by financial loss which often causes failures among fresh start-up companies. Numbers indicate that after 5 years of operating a franchise business, 95% of companies still operate, and after 10 years, 90% are still in the business, which is a far better result than the one present in the case of the individual entrepreneurs. Among individually owned and operated businesses, 40% fail after only 3 months of conducting business (Vukmir, 2000).

Franchising enables a large number of brands to become globally known names which influence globalization by making one product/service available all over the world. At the same time, franchise businesses homogenize the habits of people from different cultural and historical origins.

**Franchising in Croatia.** The franchising business model has been present in Croatia since 1969 when Diners Club International sold its franchise to Atlas travel agency. Since then between 120 and 150 franchises, mostly international ones, have been established in Croatia. The best known franchise in Croatia is McDonald's, which opened its first restaurant in Zagreb in 1996. The Croatian Franchise Association estimates that there are approximately 900 franchise outlets in Croatia with 16,000 employees in 20 different sectors, primarily trade and hotel and leisure industry (Benčić, 2008).

Potential obstacles for even greater number of franchises entering the Croatian market are the lack of specific laws regulating franchise business, lawyers poorly educated on franchise topics, the lack of financial support, a relatively small population, weak purchasing power, a high level of corruption, an inefficient legal system and high taxation.

There has been no continuous survey for monitoring the number of domestic and foreign franchises in Croatia, their operating sector, or any other significant statistical data. There are no empirical findings concerning questions which could contribute trend analysis and forecasts of future franchising development. Such analyses and forecasts could be studies of franchisees' satisfaction with accomplished business results, franchisee opinion of activities that could lead to continued business growth and faster development, the franchisees' opinion of their competition, the franchise brand's ability to attract clients to the franchisee, the significance of education organized by the franchisor to obtain new and keeping existing clients, and the profitability of a transfer from independent to the franchise business model. The purpose of this survey is to, among other things, answer some of these questions.

The question of attracting customers is answered by one's willingness to invest in the franchise. Questions are not answered: Activities that could generate more growth, more competitors, and greater profitability.

### 1. Objectives and methodology

This paper researches some of the key factors for achieving success in franchising businesses. The study of such factors is intended to lead to better understanding of current trends in Croatian franchising and forecast its further development and growth dynamics of the companies offering such business models. In addition, knowledge can be gained as to what product/service types are offered by domestic and foreign companies which choose the franchise model as a strategy for their business expansion.

The main empirical objectives this paper strives to achieve are divided in three parts: not all of these

specific research topics that follow are addressed in this manuscript, or they are simply mentioned without elaboration.

1. **Franchise purchase/investment conditions** including reasons for franchise purchase, duration of franchise contractual relationships, price categories and franchise origin, regions where franchises are active (included in Table 1), time period of franchise business activity (is this addressed when the percentage of franchises that are still operational after a certain period of time is presented?), source of information used for the franchise purchase decision and the number of franchise company employees (shown in Table 1, but without further discussion).
2. **Franchise educational programs**, including whether franchise offers educational programs and for which employee level those are offered, the visit frequency and the lesson frequency of educational programs and the impact of education on generating increasing sales volume and its impact on franchisee's overall satisfaction level.
3. **Franchise specific business characteristics satisfaction**, including overall franchisee's satisfaction with present business results, development, fulfillment of promises made by franchisor, franchisor's business improvement and the assessment of opportunities for a stronger business growth. Also, the franchisor's service impact on the franchisee's service quality towards client, prolongation plan of the contract relationship and additional services offered by franchisor.

The survey was conducted from January to May 2010, by questionnaire containing 25 questions (it would be of great help to include the survey instrument) via e-mail and regular post. The 62 franchise companies operate in different sectors but all are located in Croatia. Twenty-seven correctly completed questionnaires were returned, a response rate of 44%. The return is still a small sample size; therefore mostly descriptive statistics have been used. Data processing was conducted with SPSS 18.0, a software package for statistical processing of quantitative and qualitative data of social surveys.

Table 1. Sample structure

Organizational characteristics (%)		
Company's industry	Retail	44%
	Personal services	30%
	Education	4%
	Wholesale	4%
	Other	18%
Number of employees	0-20	78%
	21-50	11%
	50-100	0%
	100-more	11%

Table 1 (cont.). Sample structure

Organizational characteristics (%)		
Geographical region in Croatia	Entire Croatia	7
	Zagreb county	10
	Varaždin county	1
	Istra county	2
	Primorje county	2
	Krapina-Zagorje county	1
	Zadar county	3
	Dalmatia county	5
	Dubrovnik-Neretva county	2
	Slavonija	1

Source: Survey.

As part of this survey, several hypotheses have been tested.

*H1: Most of the activated and offered franchises in Croatia are categorized as low price/investment.*

Three factors affect increases in franchise sales on the macro level: high unemployment, a turbulent stock market and the decline in financing activities by banks. Unemployment has been a great problem in Croatia for a long period of time, in September 2009 the unemployment rate was 14.7% (Croatian Bureau of Statistics, 2010). The domestic stock market is rather unstable, which causes investment in equity stock. Banks in Croatia set stricter borrowing conditions for both citizens and entrepreneurs and increased interest rates. Both of these actions led to decline in the number of approved loans. Because investors still had capital for investment, the franchising model, with its potentially high rate of return, became a proper alternative to stocks.

Franchises whose initial cost is less than \$50,000 in most industries are considered to be low priced franchises (Luther, 2009), and according to Castrogiovanni, Combs and Justis (2006), the market for low priced franchises is much larger than that for higher-priced franchises. It might be helpful here to use some of the data from the attached report on franchise start-up costs. It might help people “anchor” what is meant low-prices and high-prices.

*H2: Domestic franchise opportunities in Croatia follow world trends in this industry.*

The second hypothesis deals with types of industries offered by franchising companies in Croatia and their representation ratio. The assumption is that domestic franchisors follow international trends in franchise offerings, regarding the industry type in which company does business and that this trend serves as a base for planning business expansion by offering a franchise.

Foley indicates that the fastest growing franchise service industries are maintenance, business service, health, and fitness concepts, although the food sector still dominates franchise business. Eastern European countries, including Croatia, mostly accept business services, but concepts such as cleaning, carwash and elderly care are little-investigated concepts in developing markets (Foley, 2009). This needs some clarification – cleaning, car washing and elderly care are considered service businesses.

*H3: Franchisees' business success is positively related to its satisfaction level with service provided by the franchisor.*

A franchisee will remain a part of a certain franchise as long as he is convinced that the contribution given to the business partnership is properly valued by the franchisor. It is, therefore, very important for the franchisor to manage franchisees' perception of the received value efficiently and consistently

Eric Stites, founder/president of Franchise Business Review says that franchisees' satisfaction is one of the most critical factors to the long-term success of any franchise system (Wolf, 2006). Additionally, services offered by the franchisor are fundamental for improving the relationship quality between franchise partners, because this relationship starts from a franchisee's first impression of franchisor's services. That is why franchisor's services have a great impact on the franchisee's overall commitment and satisfaction.

Limitations for the survey were numerous, and can be divided to a problem connected to the lack of systematic franchise data in Croatia, and the problem of the uncooperative respondents regarding survey participation.

There is no systematic analysis of the franchise development and no official data of number of active and non-active franchises in Croatia. There are two organizations whose main task is franchise business promotion in Croatia – *Franchise center* and *Croatian Franchise Association*. As of recently, good organizational conditions for news and trends monitoring of Croatian franchise market have been set by the legislation especially since there is a growing number of franchises in the Croatian market. Systematic data regarding franchise businesses, their results and trends surely will be a strong motive to consider franchise as one of the first business possibility for entrepreneurs who are currently planning to start a business.

The second obstacle in data collection for empirical part of survey has been connected to the lack of communication with some franchisees and franchisors because they are very skeptical towards surveys. This is a cultural issue that could be explored further.

## 2. Survey results

Basic empirical findings of the conducted survey are given in the remainder of this paper. Summary of franchise purchase/investment conditions:

- ◆ Majority (33%) of the examined companies are new franchisees, which are active less than 1 year, employing up to 20 employees (78%). Before buying a franchise owners worked as an independent company (56%) and their franchise contractual obligations are for 5 or more years time period (74%).
- ◆ Majority of responding companies (12) are active in retail (health, food, clothes and electronics sale), 8 are active in the service sector (real estate and body shaping).
- ◆ Majority respondents (74%) stated that the first information about the franchise they purchased came from a personal reference.
- ◆ 74% of responding companies purchased franchise from the low price category – up to 50 000€, and 68% of the franchises bought are already established internationally.
- ◆ 3 most important reasons for purchasing a franchise for majority of the respondents were: brand power; proved success of other companies already doing franchise business; economy of scale provided through franchise.

Survey results regarding franchise educational programs:

- ◆ Majority of franchises (89%) offer educational programs to their franchisees.
- ◆ Education is organized for both owners and employees according 85% of respondents.
- ◆ For 56% of respondents franchise education is organized once or twice a year and is attended by the majority (89%) of them.
- ◆ 78% of respondents are satisfied with the franchise education.
- ◆ 67% of respondents confirm that franchise education is responsible for a sales volume increase.

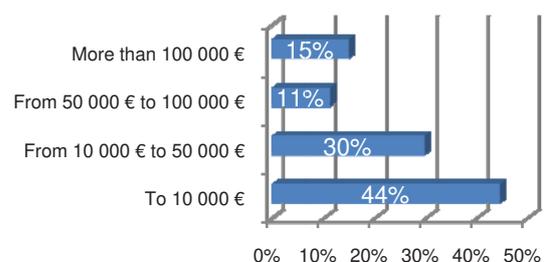
Survey results concerning franchise-specific business characteristics satisfaction are as follows:

- ◆ The most represented additional services offered by the franchisor, next to education, are: support to designing promotional material (74%), joint marketing campaigns (70%), joint supply of marketing material (63%) and working system training (59%).
- ◆ 81.5% of respondents plan to prolong their contractual agreement with the franchisor.
- ◆ As a chance for a significant business growth, 7 companies regard expansion in the number of

new outlets, supply extension (6) and buyers' increased interest (5).

- ◆ For the majority of respondents (48%), the main competition is other independent company in the same field which operates outside the franchise model.
- ◆ 74% of respondents are satisfied with the present business development, present business results (59%), franchisor's promise fulfillment (78%) and franchisor's business improvement over the time (81%).
- ◆ 74% of respondents agree that franchise based business is responsible for a certain amount of sales increase.
- ◆ 81% of respondents agree that the service quality given to a client from franchisee depends to certain extent on service quality given to franchisee from franchisor.

In order to verify H1, respondents answered the question regarding franchise category based on the initial franchise fee. Results show that the majority of franchises participating in this survey belong to the low price category as the entrance fee for 44% examined companies was less to 10 000€, and for 30% is between 10 000€ and 50 000€. Middle price category, between 50 000€ and 100 000€, suited 11% of respondents and the high price category suited 15% of respondents. The total percent of entrance fees less 50 000€ accounted therefore to 74%, what makes the majority of all respondents. The H1 is confirmed, and the results are presented in Figure 1.



**Fig. 1. Franchise categories based on initial fee criteria (N = 27)**

International (foreign) franchises are more represented in this survey (68%) which is one of the indicators of undeveloped franchise market in Croatia, especially when it is known that well developed markets favor domestic franchises. For example, domestic franchises account for 83% in Spain (Franchise Info, 2009), France – 59% (Info Franchise, 2010), Germany – 90% (Franchiseverband, 2010).

As can be seen from Figure 2, most of the franchises from the research belonged to foreign brands while only 7 had a Croatian origin. According to the type of business survey showed that various services have been accounted for.

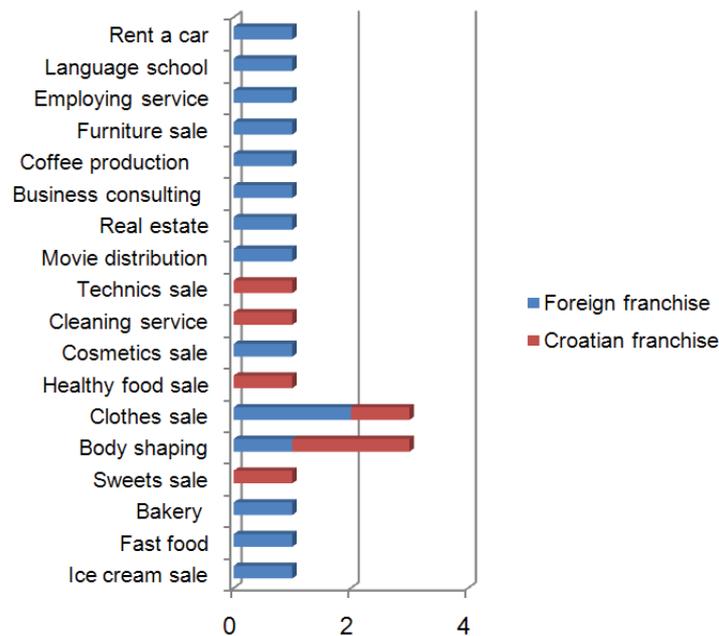


Fig. 2. Domestic vs. foreign franchises representation by industry category (N = 27)

The fastest growing franchise services by type are health, food and fitness concepts, maintenance, elder people care and rent-a-car, so the conclusion is that Croatian franchises only partially follow franchise development trends, insufficiently to approve the second hypothesis. There is a lot of space for a new domestic development which would follow the global trend in franchise type representation.

Regarding satisfaction, majority of respondents (74%) are satisfied and very satisfied with present franchise business development, 59% is satisfied and very satisfied with present business results which are very positive.

Franchisors' promise fulfillment is satisfying for 78% of respondents (56% satisfied, 22% very satisfied), and a great majority of respondents (81%) are satisfied and very satisfied with business improvement made by the franchisor over the time.

74% of examinees accepted the claim that only their franchise made an additional earnings possible (48% agrees, 26% completely agrees). Since one of the main reasons to buy a franchise is its brand, it is expected for most of new sales to be generated solely due to franchise brand power.

67% of respondents agreed with a second claim that the education offered by franchisor made additional sales increase more possible (52% agrees, 15% completely agrees). It is likely to conclude that a majority of respondents finds franchise education efficient enough. The assumption is that a bad education wouldn't generate new deals for the company.

81% of respondents agree with a claim that "service quality that franchisee gets from franchisor affects the quality service that franchisee offers to a client"

(44% agrees, 37% completely agrees). Conclusion to be made is that franchisees rely on the franchisor's support. If that support fails franchisees aren't able to offer their clients a proper service.

Analyzing answers to all questions it can be concluded that the results are in correlation because more than 50% respondents expressed their satisfaction with present business development, results and promises fulfillment and business improvement made by franchisor. Also, more than 50% consider franchise brand and/or franchise education responsible for generating sales or acquiring new customers. They also agree that service quality given by franchisor affects franchisee's service quality to a client, but in order to approve this thesis it needs to be checked is there a positive correlation between answers to given questions. Table 2 shows these results.

There is no statistically significant correlation between answers, except between the following:

1. Franchisee's business success measured by business development and franchisor's education ( $r = 0.429; p < 0.05$ )
2. Franchisee's business success measured by franchisor's support and franchisor's education ( $r = 0.420; p < 0.05$ )
3. Franchisee's business success measured by business improvement and education made by franchisor ( $r = 0.407; p < 0.05$ )
4. Franchisee's business success measured by franchisor's fulfillment of given promises and franchisor's service quality to franchisee ( $r = 0.614; p < 0.01$ )
5. Franchisee's business success measured by franchisor's business improvement and franchisor's service quality to franchisee ( $r = 0.521; p < 0.01$ )

Table 2. Relation between franchisee's business success satisfaction and the level of service given by the franchisor

	Franchise is responsible for most of a sales growth	Education provided by franchisor is responsible for generating sales	Support provided by franchisor influences quality of service provide to the end-customer
Satisfaction with the company and business development	0.307	0.429*	0.268
Satisfaction with sales results	0.312	0.286	0.168
Satisfaction with franchisor's support	0.133	0.420*	0.614**
Satisfaction with development of franchise during time	0.236	0.407*	0.521**

Note: \*Correlation is statistically significant to a coefficient less than 0.05, \*\* correlation is statistically significant to a coefficient less than 0.01.

Conclusion is that there is a positive correlation between a number of variables connecting franchisor and franchisee relationship and their interdependence for successful franchise development. This leads to the acceptance of H3.

Recommendation for further surveys concerning similar topics would include a survey questioning reasons for some franchises to withdraw from the market. That would help detecting some joint reasons which make franchise business in Croatia hard to operate. These data could help present franchises to adjust their business and eliminate negative effects, but also could help franchises which are just planning to enter the Croatian market not to repeat the same mistakes.

### Conclusion

The Franchise business model represents a large share of global business, but it is most represented in developed markets. By its economic power, Croatia is placed among the developing countries, and one of the arguments for this kind of categorization is the level of franchise business in Croatia. If Croatia is compared to its neighboring countries (former Yugoslavian republics), then available figures are in favor of Croatia, but widening the context toward developed countries such as France, Germany, Italy or Spain, which first adopted the franchise business model, or even eastern Europe countries like Hungary or Poland, show that Croatia is falling behind, not only in the franchise supply, but also in monitoring statistics regarding franchise businesses. Present numbers owned by franchise professionals are rough and arbitrary, and that is why it is extremely important to develop a reliable survey as soon as possible which would show the real condition of franchising in Croatia. There is only a small number of economically strong companies in Croatia and there is minimum job security. These facts suggest that it is likely that citizens will consider starting their own businesses. The Franchise business model is ideal for future entrepreneurs, because it can be customized for different financial possibilities offering wide range of price categories.

The main conclusions regarding the theoretical part of this paper are that Croatia represents a very suitable location for developing a franchise business model for potential franchisees, but also to potential franchisors, who are ready to invest their time and money in a business model already proven in numerous developed markets. Although franchising has many advantages, every entrepreneur has to be aware that not every franchise concept is suitable for every market. Before making the final decision about buying or selling franchise rights all available sources of information should be considered and the advice heeded in order to prevent financial losses.

The main hypothesis of the empirical part of the survey is that most of active and offered franchises in Croatia are low priced, that *franchise supply in Croatia follows global trends* in sector representation and that franchisee's business success relates positively to the satisfaction with the franchisor's service level provided to the franchisee.

Conclusions of the empirical part of the survey are: most of the examined franchises in Croatia are low priced, which relates to the assumptions based on the collected data, and by this conclusion the first hypothesis of the survey is approved. Franchise supply in Croatia *doesn't* follow the world trend regarding the type of business, which does not support the second thesis. Franchisee's business success relates positively to the satisfaction with the franchisor's service level provided to the franchisee, so the third thesis is also confirmed.

This becomes confusing in its redundancy. Stating the hypotheses separately from the support or lack of support for them just appears contradictory rather than informative.

The survey results show that Croatian market attracts price sensitive franchises, a good prognosis, not only for all franchises concerning their possible entry into the Croatian market, but also for all Croatian entrepreneurs who consider expanding their business concept through franchises. An important

recommendation for the potential franchisees is to adapt to world trends regarding franchise business type selection, because survey results show that present franchises don't follow the current trends.

Franchisors should pay a lot attention to quality of support given to their franchisees, as it is crucial for franchisee's business success, which directly reflects franchisor's success.

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## Appendix. Survey

Translation of questions from the survey:

Q.1. For how long does your company operate under franchise?

1. Up to a year.
2. 1 to 5 years.
3. 5 to 10 years.
4. More than 10 years.

Q.2. Did you operate in the same business before buying a franchise?

1. Yes
2. No

Q.3. How did you learn of a franchise you have bought (multiple answers are possible)?

1. Recommendation.
2. Media.
3. Croatian Chamber of Commerce.
4. Franchise Association (which one?) \_\_\_\_\_.
5. Other source (which?) \_\_\_\_\_.

Q.4. Please rank according to the importance reasons for buying a franchise by using numbers 1 (most important) through 7 (least important).

- \_\_\_ Franchise brand strength.
- \_\_\_ Proven success of other companies using the same franchise.
- \_\_\_ Educational programs offered.
- \_\_\_ Legal and administrative support.
- \_\_\_ Using economies of scale together with other franchise buyers (joint investments in marketing, buying, etc.).
- \_\_\_ Support of other franchisees in the franchise network.
- \_\_\_ Something else (what?) \_\_\_\_\_.

Q.5. What was the price level of initial fee for your franchise?

1. Up to 10 000 euro.
2. From 10 000 to 50 000 euro.
3. From 50 000 to 100 000 euro.
4. Over 100 000 euro.

Q.6. Duration of signed franchise contract:

1. Up to 3 years
2. From 3 to 5 years
3. From 5 to 10 years
4. More than 10 years

Q.7. Please rate on scale 1 to 5 how satisfied are you with certain elements of your business.

	Extremely unsatisfied	Not satisfied	Not satisfied not unsatisfied	Satisfied	Extremely satisfied
Your satisfaction with the company and business development	1	2	3	4	5
Satisfaction with sales results	1	2	3	4	5
Satisfaction with franchisor's support	1	2	3	4	5
Satisfaction with development of franchise during time	1	2	3	4	5

Q.8. What do you see as an opportunity for business growth regarding support of your franchise?

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Q.9. Your main competition is:

1. Another franchise in the same sector.
2. Non franchise (independent) company in the same sector.
3. Else (what?) \_\_\_\_\_.

Q.10. Please rate on scale 1 to 5 level of agreement with the following statements:

	Completely disagree	Disagree	Do not agree or disagree	Agree	Completely agree
Franchise is responsible for most of a sales growth	1	2	3	4	5
Education provided by franchisor is responsible for generating sales	1	2	3	4	5
Support provided by franchisor influences quality of service provide to the end-customer	1	2	3	4	5

Q.11. Does your franchisor offer education and training?

1. Yes
2. No

Q.12. Education by franchisor is organized for:

1. Franchisee.
2. Employees.
3. Both.

Q.13. How often does your franchisor organize educational activities?

1. One time per year.
2. Two times per year.
3. Three times per year.
4. Four times per year.
5. More than four times per year.

Q.14. Do you and your employees participate on such educations?

1. Yes
2. No

Q.15. To what extent are you satisfied with education and training provided by franchisor?

Extremely unsatisfied	Not satisfied	Not satisfied not unsatisfied	Satisfied	Extremely satisfied
1	2	3	4	5

Q.16. What other support services are offered by your franchisor (multiple answers are possible)?

1. Organization of the conferences.
2. Web seminars.
3. Joint marketing campaigns.
4. Joint supply of marketing materials.
5. Transfer of know-how.
6. Bookkeeping and accounting.
7. Financial support.
8. Business planning.
9. Administrative and IT support.
10. Else (what?) \_\_\_\_\_.

Q.17. Do you plan to extend your franchisee contract after expiration?

1. Yes
2. No
3. Not sure.

Q.18. Which additional services could be provided by franchisor in order to increase your satisfaction with the franchise?

\_\_\_\_\_.

Q.19. Business sector in which franchise operates:

1. Retail.
2. Production.
3. Other services.
4. Education.
5. Transportation.
6. Tourism.
7. Wholesale.
8. Logistics.
9. Banking.
10. Insurance.
11. Something else (what?) \_\_\_\_\_.

Q.20. Croatian region in which the franchise primarily operates?

\_\_\_\_\_.

Q.21. Number of employees:

1. Up to 20.
2. 21-50.
3. 51-100.
4. 100 or more.

Q.22. Your current occupation – job position:

\_\_\_\_\_.

Q.23. Sex:

1. M
2. F

Q.24. Age:

1. 18-29.
2. 30-39.
3. 40-49.
4. 50-65.
5. 66 or more.
6. No response.

Q.25. Education level completed:

1. Elementary school.
2. High school.
3. Higher school.
4. University graduate or more.