Perhaps no greater symbol of the power of a franchise model exists anywhere in the world than at the Starbuck's Cafe in the Forbidden City in Beijing. But this iconic presence, its apparent success as a business model, masks a confused reality.

Proved the most successful way of starting a new business, franchising has become a force to be reckoned with in China, even if the term "franchising" is only vaguely understood and its limits as a business model here are ill-defined.

Few people can tell if franchising means a joint venture, a chain store, direct selling, network marketing or even pyramid selling, as some of the meanings mistakenly attributed to the system suggest. But, fundamentally, it is a successful model for the conduct of business and for developing a partnership.

There is no obvious explanation for the confusion, said Philip F. Zeidman of the US law firm DLA Piper Rudnick Gray Cary, especially since it is expected that 168,000 franchised stores will be operating throughout China by the end of 2006. Yet, confusion does arise and in some cases, the confusion can deliberately mask an illegal activity such as a pyramid scheme, a marketing scheme now outlawed in both China and the United States.

But there is no confusion about the fact that in the most rapidly growing economy in the world, predictions are that the franchise sector will represent 30 percent of China's total retail sales within the next five years, a growing trend reflected around the world.

"Franchising has an astonishing presence in the global economy," said Zeidman.

Franchising is worth an annual US$1.5 trillion across the globe, employing in excess of 9.5 million people in 760,000 franchised businesses worldwide.

"It represents 7.5 percent of all independent or commercial-sector jobs and 5 percent of their payroll in the United States." He said the economic value generated was equal to that of the manufacturing of all durable goods in one year.

Across 60 industries there, the franchise sector now has 800,000 retail franchise outlets.

"If you apply the multiplier effect, this means that one in seven people are directly or indirectly employed by the franchise sector in the United States," said Zeidman.

Franchising is a system with its own terminology, and that may be where some of the confusion arises in China. It is a business system that allows a businessperson called a "franchisor" to put up for sale a proven business model, to be bought and operated by an investor called a "franchisee." The business, called a "unit," is then run between the two parties as a legitimate business partnership. It involves neither direct nor pyramid selling, according to Zeidman. It requires substantial start-up costs and entrance fees to get involved and royalties must be paid annually to brand holders.

Claude Moreno, CEO of Oriental Marketing Services, a Hong Kong-based franchise consultancy with representative offices in Shanghai and Beijing, who has 12 years experience of doing business in China, said, "Local business people here are confused by the model. They don't expect to have to pay for brand rights and don't want to have to pay to enter. There's considerable confusion over what a franchise is: a joint venture or what?"

Examples of successful global franchise systems in China include Subway, TNT, 3M, Cambridge English, Century 21, DIO Coffee and Duraclean, all of which touted their operations at the Eighth Annual Franchising China Conference & Exhibition in 2005. The 2006 meeting will be held at the China World Exhibition Centre in Beijing in November.

As two of the most famous franchise systems in China and around the world, Kentucky Fried Chicken (KFC) began operating here in 1987 and McDonald's in the 1990s. Both waited until 2000 to begin franchising. Today, the minimum start-up cost for a McDonald's franchise in China is about 3 million yuan (US$375,211), with restrictions on borrowed finance capital.

It is no surprise that China is following the global franchise trend, although figures could hardly be described as dramatic, even if the Starbuck's in the Forbidden City tops all franchise marketing stories.

According to a report published in December 2005 by the China Chain Store and Franchising Association, the official representative of China's retailing and franchise industry, franchising prospects are looking quite good in China.

The report shows that 2,320 franchisor systems were in operation in China in 2005 with an average of 73 stores per single franchise system.

"With an average of 40 franchisees per system, the sector shows a 10 percent industry growth rate, nationwide, with 200 brands, 35 percent of which are in food and service. Of the top-100 companies in China, 50 percent are franchise operations," said Zeidman.

Zeidman, who was named "Top Franchise Lawyer of the Year" for 2006 by his peers, makes frequent trips to China. DLA Piper Rudnick Gray Cary have operated offices in Shanghai and Hong Kong for a number of years, most recently opening the Beijing office under the control of ex-Coudert Brothers' lawyer Janet Jie Tang in June 2006.

Known in the legal world as "the godfather of franchise law," Zeidman has some concerns about the regulatory framework that "protects" franchisees in China.

The franchise model is usually made up of a tested business concept, proven marketing and operational methods, ongoing support and training and established brand identities. Beyond that, regulation comes in the form of organisations such as the International Franchise Association that monitors and approves standards within the sector. While the franchise is a relationship not unlike a partnership where the franchisee benefits from both the proven track record and experience of the franchisor--which usually provides solid training programmes, the principal safeguards for franchisees come in the disclosure documentation provided at the outset. In the US legal regulations were developed over many years.

"One of the provisions of the Franchise Law, a new regulation in China that protects the franchisee investor, follows the "disclosure approach" that regulates conduct between parties. It relies on the model law called the "2-plus-1 rule." It was developed after 15 years of research," said Zeidman.

The first franchise law in China came in the form of the 1997 "Interim Measures for the Regulation of Commercial Franchise Operations." This was amended in November 2004 with the "Provisional Measures for the Supervision of Foreign Invested Enterprises Engaging in Commercial Franchising Business."

These provisions include the 2-plus-1 rule.

"In a sense it is a troublesome provision and unprecedented in international franchising. In effect, it means the franchisor, either domestic or international, cannot offer a franchise in China without two company-built stores having been in operation for one year," said Zeidman.

Although the law is a well-intentioned approach, Zeidman believes it to be counter-intuitive.

"The franchisee is already protected." Zeidman said a franchise agreement must include disclosure documents, a prospectus, set up requirements, start up fees and other legal documentation that address this problem.

Disclosure documents provide the evidence needed to demonstrate a proven track record and a trial run is not seen as necessary by organisations such as the IFA.

But Zeidman remains positive, even if he wonders why anyone would try to operate in ways contrary to a model that works.

"The sector undoubtedly shows great potential in job creation and income."

Claude Moreno of Oriental Marketing Services is equally optimistic.

"It is certainly true that franchising is the most successful way of getting a business started, but it is not easy and this is also true in China," said Moreno, a French citizen who has engaged in business for 23 years in Hong Kong, including three years as a franchise consultant.

Moreno says the cost of a franchise can start at 2 million yuan (US$250,141) and rise to 30 million yuan (US$3.8 million) depending on what is being built. You cannot conclude a franchising deal overnight.

"Franchising is very new in China and although it is a very good business solution, it takes time, a minimum of two to three years to enter the market. There is confusion over what it is and how it operates and whether it's a joint-venture and why it has an entrance fee and what is the purpose of paying royalties to the franchisor for the use of the brand name. But once all these questions have been answered and the 2-plus-1 rule observed, it's a great way to make money!"

Moreno says that because of the freshness of the franchise market, the pathway to developing a franchise for the franchisee is usually beset with pitfalls that consultants, like him, are usually able to iron out.

"Understanding the nature of the market in China, and Chinese business culture, is half the battle in setting this kind of business on the road to success."

While sitting in a Starbuck's, surrounded by 800 years of China's history, one can't help wondering if this marketing coup can be repeated; the future of franchising beckons.

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