



The Business Case on Food Franchising in India

KEYWORDS

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Hospitality industry is always high in demand as now a days everyone is paying attention and spending money on their comfort and quality services. Among this industry, entrepreneurs are engaging in QSR Industry like never before. If you are looking for the fastest way to expand or diversify a business, its franchising. If you purchase a franchise from a well-known fast food restaurant chain, you'll be provided with a program that increases your odds of being successful. The franchisor has already done their research and survey. Following their business plan and helping them to expand by opening a franchise is tantamount to your own effectiveness.

But do all franchising turn out to be a profitable venture is a question mark.

There are many benefits of running a food business, but there are also some challenges you need to be aware of before entering in this industry. Don't forget the fees and restrictions that come with franchise ownership. Also one shouldn't mind paying royalties or relinquishing some control to the franchisor.

Moreover franchising has a low margin especially in food industry. The food franchisee has both the cost of goods sold and labor costs to contend within an environment that is very price sensitive. The net margins of most food businesses are not nearly as high as other (particularly service-related) franchises, and you're also dealing with spoilage, theft and other issues that you don't find in many other types of franchise businesses.

With all the above facts and figures know to Mr Kundan, he was considering to begin a franchise of a fastest growing pure vegetarian chain of Pizzeria which was started in western part of India in 2012. he found out that 32 pizza restaurants (30 in western region of India and 2 in north India) spread in just a span of 4 years. Unlimited buffet at a pocket friendly rate soon wowed the customers. It was one among the QSR industry listed on National Stock Exchange-EMERGE platform.

Business Model

Mr Kundan studies their business model in depth. Unlimited salads, soups, Pizza with limited aerated drink and desserts all at rs 200(approx) in 1 hour was the deal. The virus of this deal soon caught attention of all food lovers and there were more than 4 million satisfied customers in just 48 months. Moreover the business won Best Start-up Entrepreneur Award in 2015.



Flip Side

But during his research he also came across the 2nd side of the coin. As the restaurant positioned itself as low cost pizza outlet which caters to youth and families, it wasn't easy for the franchise to breakeven who thought they make huge money. The franchise had to bear a huge cost for the business. With this in mind he immediately contacted the franchisor to know the initial capital required.

Following information he received from the franchisor.

Set Up cost	
Particulars	Amount
Franchise fees	800000
Project Cost	3000000
Total	3800000

Total set up key cost including franchise fee will be approximately 3800000 plus applicable taxes. Where 800000 is the franchise fees and 300000 includes expenses towards interior, furniture , fixtures , kitchen equipments, software staff training, Initial marketing and menu offerings.

Following is the projection cost to earn a reasonable revenue.

Projection Cost					
Particulars	Amounts				
Total sales per month	800000	900000	1000000	1100000	1200000
Less Expenses (Fixed + variables)					
Rent	100000	100000	100000	100000	100000
Staff room rent	10000	10000	10000	10000	10000
Salary	120000	120000	120000	120000	120000
Electricity bill	30000	30000	30000	30000	30000
Staff room-electricity	3000	3000	3000	3000	3000

bill					
GAS bill	25000	25000	25000	25000	25000
Marketing expenditure	10000	10000	10000	10000	10000
Telephone expenses	2000	2000	2000	2000	2000
Packaging cost	6000	6000	6000	6000	6000
F&B cost @40% of sale	320000	360000	400000	440000	480000
VAT@ 40%	32000	36000	40000	44000	48000
Royalty @ 8% on sales					
Total Fixed	722000	774000	826000	878000	930000
= variable expenses					
Profit	78000	126000	174000	222000	270000
% of Profit	9.75	14	17	20	2

Based on the table above total variable cost is 52% of sale, Therefore the contribution margin would be 48% of sales and the fixed costs totals to 306,000.

For the company to survive, the break even sales should be - 637,500 per month which will lead to no profit no loss. Over and above Break even the company would start making profits. He further investigated on the taxes.

Taxes

Taxes Like VAT which is levied on sale of any item and as food is sold in the restaurant ,VAT is liable to be paid in such sale. VAT is levied by state government of India. Different states describes different rate of VAT, many a times even same stated different rate of tax have been prescribed for different items. VAT is only applicable to the food items which are prepared inside the restaurant, because they "added some value" and then hand it over to you. VAT Charges vary from state to state, but generally lie in the range of 10% – 15% . Like in Maharashtra and Delhi its 12.5%, and in Karnataka its 14.5%. Mr opined that though VAT is to be paid by the customer it has to be included in a buffet plate of rs 219 (approx)

Also the cost of food as shown in the menu card is a composite charge and includes not only cost of raw material but also for the cost of service rendered. The central government of India collects these taxes. And the service tax is 14% at present.

Both these taxes are to be paid by customer and as per the above case it is included in the per buffet plate which range from 219 on weekdays and move towards 259 on weekends. Which means states or food items where high taxes are imposed, it will be difficult for the restaurant to keep it low cost.

Few Factual

Mr Kundan contacted few of the existing franchisee in Mumbai and navi mumbai he came across few facts.

When one of the franchise owner was asked about his profits , He was of the opinion that considering the cost in terms of rent and others will differ from location to location therefore breakeven for them was 10,00,000. Which implies that they will need a footfalls of 5000 customers per month, around 1250 customers per week and 178 per day, which may be a possible figure to bag on a weekend

but week day could be difficult. In a span of one year the franchise was shut down.

A similar experience was shared from another franchise owner in thane district. The management said that from past two year they managed to recover only the cost that was incurred to start the business. Apart from that they reveled they had a huge fixed and variable expenditure, viz monthly rent of rs 3lakh, salary to staff of rs 2lakh approx, electricity bill rs 1lakh approx irrespective of sales. According to them on an average only 40-50daily customers visits to restaurant daily, which is revenue of 11500 per day and 3,45,000 per month. Also the royalty that they had to pay to the franchisor varied between 7%-10% depending upon the sales.

Mr Kundan surveyed in the market and found that a similar business model is quiet successful in the market and also discovered that the customers going to both the restaurants were very happy with unlimited pizza concept.

Competitors

Another pizzeria restaurant running with similar business model is quiet successful by adopting various cost reduction and control techniques. One of the major difference in both restaurant is that they also serve non vegetarian food so it attacks more food lovers.

Questions

Q1. You as future manager are supposed to advice Mr Kundan whether to go for pizzeria franchisee or not? Give justification for your answer.

Q2. If Mr kundan goes for the franchising of pizzeria the what cost reduction strategies should be adopted ion order to make it a successful venture?

Q 3. Calculate the current margin of safety assuming that Mr Kundan sells 2000 meals per month?

Q4. What would happen to break-even output if the average selling price per meal increased to rs 50?

Sources of Data

Primary –

- 4 Franchise owner from Mumbai had been contacted via e mail, telephone and personal meeting to know the facts.
- The head office in western part of India was contacted via e mail and telephone to get the franchise detail

Secondary -

Websites

1. mahavat.gov.in For taxes
2. economicstimes.com
3. www.franchiseindia.com
4. www.fssai.gov.in/ Food safety and standard authority of India

Kindly note- real identity of the franchisor has not been reveled in the case and Mr Kundan is a fictitious person.