THE FRANCHISING ROAD TO INTEGRATION AND SUSTAINABLE DEVELOPMENT: THE ROLE OF VIETNAM’S FRANCHISE LAW

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1. Franchising and Sustainable Development

Franchising

Franchising is, in the words of the Australian House of Representatives Standing Committee on Industry, Science and Technology, "an increasingly popular form of economic organisation providing an alternative means of expanding an existing business or an alternative means of entering an industry". It is a method of business operation, which has revolutionised the distribution of goods and services in virtually all industry sectors and has transformed the business landscape of most countries.

Franchising has been explained as a form of economic organisation in which:

...the franchisor, holding property rights over a marketing system, business service or product (identified by a brand name or trademark) enters a contract or agreement with the franchisee and grants, under certain conditions, the right to use a business brand name or trademark and the right to produce or distribute the franchisor’s product or service.

It originated in the mid nineteenth century as a form of exclusive branded distributorship agreements - today known as product and trade name franchising - characterised by an independent sales relationship between supplier and dealer in which franchised dealers concentrate on one company’s product line and to some

1. ibid.
3. The House of Representatives Standing Committee on Industry, above n 1.
extent identify their business with that of the supplier. This form of franchising includes *product franchising* in which the franchisee has the role as a distributor, either wholesaler or retailer, for a specific product and *processing or manufacturing franchising* in which the franchisor grants an essential ingredient or know-how to the franchisee. However, the significant development and innovation in franchising occurred a century later, in the 1950s, when the current iteration of franchising - *business format franchising* - evolved. While product and trade name franchising is a relatively unsophisticated form of franchising essentially comprising branded distribution arrangements, business format franchising - the major contemporary form of franchising - is a sophisticated business relationship. In a business format franchise, the franchisor provides the franchisee with not only a branded product and/or service but also an entire business model - an overall image and a method of doing business in accordance with a proven business system, and operational and managerial systems supported by standards, training and ongoing assistance.

Business format franchising is a "symbiotic relationship in which the needs of the franchisor and the franchisee blend in a commercial marriage of convenience" which merges "the seemingly conflicting interests of existing businesses with those of aspiring entrepreneurs in a single process that promotes business expansion, entrepreneurial opportunity and shared cost and risk". The franchisor benefits from rapid expansion of its system without having to directly invest in and manage to outlets, which are financed and managed by the franchisee, and from ongoing franchise fees and, in many systems, income from product sales and service supplies. The franchisee benefits from the goodwill in the brand, and from the provision of a complete business system including initial and ongoing training and support, marketing, and economies of scale - factors which can deliver higher profit margins, lower failure rates, easier entry into the market place, and lower capital requirements.

Franchising in Developing Countries

Franchising has proved to be "a viable method of distributing goods and services which can have a positive influence on economic development"1. The 1997 Consultative Survey on Franchising in the APEC Member Economies stated that:

By supporting and encouraging the development of business format franchising, APEC governments can help the growth of small and medium enterprise. The franchising track record is full of examples of small businesses that grow and in turn foster other small businesses2.

Franchising is a particularly effective tool for economic development and international integration in developing countries3 and is a proven strategy for SME development. It may be the most effective method for developing countries to build a services oriented economy4. Through the international expansion of foreign franchise systems, developing countries are introduced not only to new products, services and technologies but also to training, business advice and operational and managerial experience in relation to those systems. Foreign franchisors provide franchisees not only with system know-how but also with a range of management skills. The most enduring legacy of the expansion of international franchise systems to developing countries is nevertheless the development of domestic franchise sectors. The international systems stimulate entrepreneurial activity and are the catalyst for the development of domestic franchise systems not only for the benefit of local entrepreneurs and their franchisees but also for consumers and society generally5. For these reasons, franchising is a particularly attractive business strategy in developing countries.

While franchising faces increasing saturation in developed countries of North America (the US and Canada) and Western Europe (particularly Germany and the

5. Andrew Terry, 'A Comparative Analysis of Franchise Regulation in the Asia-Pacific Region' (Paper presented at the LAWASIA Conference, Christchurch, New Zealand, 4-8 October, 2001).
UK), it is still relatively untapped in developing countries. With four fifths of the world’s population and three fifths of the world’s natural resources, the developing countries are attractive destinations for foreign franchisors. The US Department of Commerce has recently estimated that the developing countries will account for over three quarters of the world’s expected trade growth in the next two decades. While franchising is an invention of western capitalism which increasingly dominates the market places of North America and Western Europe, its most exciting future is likely to be in the developing countries of Asia where its business development potential is already having great influence. China is a good example. Franchising was introduced to China only in the late 1980s, yet China today is the world’s most franchised country with respect to the number of franchise systems with over 4,000 systems by the end of 2009.

**Franchising in Vietnam**

Franchising is a relatively new but steadily developing strategy in Vietnam, which is one of the world’s newest franchise countries. At the time when franchising was becoming popular in many developed countries, Vietnam was at war. The Anti-French war started in 1945 only a few days after the establishment of the Democratic Republic of Vietnam (today the Socialist Republic of Vietnam) and ended in 1954. The Anti-American war started in 1954 and ended in 1975 when the Socialist Republic of Vietnam was reunited. Franchising could not develop in this


3. *ibid.*

4. This is the number of systems recorded by the China Chain-Store and Franchising Association (CCFA), but the number of franchise systems officially registered with China’s Ministry of Commerce is significantly less.

environment, nor in the closed, subsidised, bureaucratic, and centrally planned economy which existed following reunification and in which private enterprise had no place. The introduction of the *Doi Moi* policy in 1986, which moved Vietnam to a socialist oriented market economy and opened the door to the outside world including western countries, led to an economic environment in which franchising could operate.

Franchising did not appear in Vietnam until the mid-1990s when the business environment became more attractive to foreign investors because of many economic and legal reforms and its deeper international integration, particularly after the lifting of the US commercial embargo in 1994. As in most countries, franchising first appeared in Vietnam through the expansion of foreign franchisors. The pioneer franchisors, including *Jollibee* (from the Philippines), *Lotteria* (from South Korea) and *KFC* (from the US), came to Vietnam in the period 1996-1997. However, in the first 10 years following the introduction of franchising, there were only 23 franchise systems which, with few exceptions, owned and operated their outlets rather than franchised them. Franchising has nevertheless experienced steady development since 2006 when Vietnam introduced dedicated franchise regulations which for the first time recognised franchising as a discrete business method. In the five years following the introduction of Vietnam’s *Franchise Law*, the number of franchise systems increased over fourfold, from 23 to 96.

Although the size of franchising sector in Vietnam is still limited, and most system outlets are owned and operated by franchisors, Vietnam is a promising franchise market. A high and stable GDP growth rate (at around eight percent in recent years)\(^1\), a highly literate and young population, political stability, wide international integration, and extensive legal reforms driven by WTO accession commitments - in particular the introduction of a dedicated franchise law - has made Vietnam an attractive country for franchising. In the words of the General Director of *KFC* Vietnam, "Vietnam is not only a promising market for fast food but also for franchising in other areas"\(^2\).

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2. The Need for a Franchise-Specific Law

Although the Doi Moi reforms led to a market environment in which franchising could operate, the development of the franchise sector was constrained by the lack of a clear legal framework. Until the introduction of the new regulatory regime, franchising was not recognised as a discrete business relationship and, in a country where the general rule is that anything not being specifically permitted is not allowed\(^1\), franchise development was not practicable. As explained by Vision and Associates, a Vietnamese law firm specialising in franchising, "without a legal frame of reference Vietnamese authorities simply consider a franchise agreement as a trademark licence, technology transfer contract, and/or service agreement. Such agreements will therefore be subject to different regulations under current Vietnamese law\(^2\). Instead of entering the sector through a franchise agreement, an intending franchisor generally entered through one or several other contracts which was like "hammering a square peg into a round hole"\(^3\) discouraging both potential domestic and foreign franchisors. These problems drew attention to the urgent need to enact a franchise-specific law for Vietnam as a necessary prerequisite for the development of a Vietnamese franchise sector.

Accompanying this pressure was the fact that Vietnam, as part of its preparatory steps for WTO accession, faced the urgent need to modernise its laws to provide a legal framework more consistent with international practice and more favourable for business. These factors led to a dedicated franchise regulation being introduced as a part of the new 2005 Commercial Law, which replaced the 1997 Commercial Law. The necessity for the new 2005 Commercial Law was acknowledged by the Government:

Many new commercial activities have just appeared or been favoured by businesses, however, there has not yet specific regulations on them whereas general regulations under the 1997 Commercial Law could not be applied to them (for example, franchising and sale of goods through good exchange)\(^4\).

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1. ibid.
The introduction of Vietnam’s *Franchise Law* - the first element of which was the inclusion of a Chapter in the 2005 *Commercial Law* - was a response to the practical requirement for a clear legal framework for the development of franchising. This was acknowledged by the Government when submitting the eighth draft of the 2005 *Commercial Law* to the Parliament. Although there is not any statement of purpose, in the proposal document for the 2005 *Commercial Law*, the Government acknowledged that the introduction of dedicated franchise regulations was to encourage the development of franchising and to ensure legal rights and obligations of parties in franchise relationships.

### 3. Vietnam’s *Franchise Law*

Vietnam’s *Franchise Law* provides a clear and dedicated legal framework for franchising in Vietnam. It comprises four components - the 2005 *Commercial Law* providing a framework for regulating the franchise relationship; the 2006 *Decree Making Detailed Provisions for the Implementation of the Commercial Law with Respect to Franchising Activities*; a Ministry of Industry and Trade *Circular Providing Guidelines on Procedures for Registration of Franchising Activities*; and a Minister of Finance *Decision Providing the Regime for the Collection and Payment, Management and Use of Charges for Commercial Franchising Registration* addressing registration and prior disclosure which are key features of the regulatory regime. Recently, some articles in *Decree 35* have been amended by *Decree 120* (in 2011) of the Government *Amending and Supplementing Administrative Procedures Stipulated in a number of Decrees of the Government Detailing the Implementation of the Commercial Law*.

Vietnam is one of over 30 countries which have introduced a franchise-specific law to supplement the underlying commercial laws. The *Franchise Law* adopts an increasingly familiar regulatory model. It stipulates comprehensive franchisor prior disclosure with moderate relationship obligations. A "light touch" registration regime, which was included in the *Franchise Law* was virtually removed by *Decree 120* in 2012, being retained only for international franchisors franchising into Vietnam.

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2. This is the document explaining the rationale for the introduction of the law and the main issues addressed in it.
4. However, the annual report of franchisors is still required to support data collection.
Prior disclosure - which addresses the information imbalance inherent in the typical franchise relationship - is generally considered as the key to franchise regulation. Consistent with international best practice, Vietnam also uses prior disclosure as its central regulatory tool. The prior disclosure provisions are broadly similar to the requirements of those countries which adopt a comprehensive disclosure regime including the US, Australia, China, Malaysia, and also UNIDROIT’s *Model Franchise Disclosure Law*.

Relationship/conduct issues arising from the power imbalance are also addressed in Vietnam’s *Franchise Law*, particularly through imposing moderate restrictions on the rights and obligations of the parties in the franchise relationship. Vietnam, like many regulated countries, provides restrictions on unilateral termination by the franchisor and follows the common formula of allowing termination only on prescribed termination events and the giving of a default notice and the opportunity for the franchisee to remedy its breach. Vietnam also mandates several rights and obligations of both franchisors and franchisees.

Vietnam’s *Franchise Law* generally subjects both foreign and domestic franchisors to the same regulatory regime\(^1\) which is consistent with, and indeed required by\(^2\), international best practice. Previous restrictions as to business forms and the extent of foreign capital ownership in foreign invested enterprises involving franchising have been lifted as consequence of Vietnam’s WTO accession commitments.

Vietnam’s regulatory regime for franchising is broadly consistent with international best practice. It is, in the words of Baker and McKenzie lawyer Giles Cooper, "modern and well-drafted, and balances commercial freedom and protection of franchisees\(^3\). Cooper further states that "new specific domestic legislation and recent WTO commitments on franchising have laid the groundwork for a likely explosion in activity in this dynamic sector"\(^4\). However, the gaps in the protection provided for franchisees, and the ambiguity of several provisions, are issues of concern for both franchisors and franchisees. The lack of unification and

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1. However, under *Decree 120* (in 2011) the registration obligation remains only for foreign franchisors which raises a concern as to a unified regime for both domestic and foreign franchisors and seems inconsistent with Vietnam’s WTO accession commitment.
2. Vietnam’s WTO accession commitments.
4. *ibid.*
synchronicity of provisions between the *Franchise Law* and underlying commercial regulations is a particular concern. The governing *Commercial Law* unfortunately makes certain of the franchisor’s obligations subject to the proviso "unless otherwise agreed" (article 287) which contradicts the mandatory regime of *Decree 35* and *Circular 09*. Although in practice implementing regulations are treated as having higher validity than the source document, this approach is not consistent with Vietnam’s transition to a law-based State.

4. The Development and Contribution of Franchising in Vietnam

*Steady Increase of Franchise Systems and Outlets*

With the introduction of a dedicated *Franchise Law*, a clear legal framework for franchising has fostered the development of franchising. In the seven years since the introduction of the *Franchise Law*, there has been a significant increase in the number of franchise systems in Vietnam, including many famous brands from abroad. Research conducted by the authors suggests that Vietnam currently has around 116 franchise systems, comprising 96 foreign franchisors and 20 domestic franchisors. The franchise systems which existed before 2006 including *KFC, Jollibee, Lotteria,* and *Pho 24*, have experienced strong development over this period.

Although in comparison with other countries such as the US, Australia, and China the size of franchise sector in Vietnam is still small, it has been developing steadily since 2006. In seven years after the introduction of the *Franchise Law*, from 2006 to 2012, the number of franchise systems has increased over fivefold from 23 to 116 as illustrated in the following chart.

*Figure 1: Number of Franchise Systems in Vietnam*
The statistics in Figure 2 also show that there has been a significant expansion of foreign franchisors since the commencement of the Franchise Law - from 13 foreign franchise systems in 2005 to 96 in August 2012. The annual rate of system growth has been around 50 percent until the last three years when the effect of the global financial crisis impacted on system growth.

Figure 2: Number of Foreign Franchise Systems in Vietnam

Although not increasing as rapidly as foreign franchisors, domestic franchisors have gradually increased from 10 franchise systems in 2005 to 20 franchise systems in August 2012 (see Figure 3). While this is not a significant increase it must be noted that 95 percent of Vietnam’s businesses are SMEs with little business experience and a lack of franchising knowledge. These factors have impacted on the development of franchising in the SME sector. However, a number of local companies - including such well-known local brands as Vissan Limited Company (Vissan), Agrex Saigon Foodstuffs Joint-stock Company (Agrex), and Hanoi Trade Corporation (Hapro) - are reportedly considering franchising as the best strategy to expand their systems in Vietnam and abroad. Moreover, several of the current local


franchisors have expanded overseas including *Trung Nguyen Coffee*, *Pho 24*, *AQ Silk*, and *Foci*. With its first overseas outlet in Japan in 2001, *Trung Nguyen Coffee* is now operating in many other countries including Thailand, Cambodia, Singapore, Malaysia, China, Ukraine, Poland, Germany, and the US. *Pho 24* currently has 10 outlets overseas in Cambodia, the Philippines, Indonesia, Singapore, South Korea, and Australia.

*Figure 3: Number of Domestic Franchise Systems in Vietnam*

In addition to the increase in the number of franchise systems, the rate of franchise outlet development is also steadily increasing. Franchise system outlet numbers increased from 700 in 2007 to 890 in June 2008\(^1\). This can be seen very clearly in the outlet development of some franchisors. For example, in the decade to 2005, the number of outlets of *Jollibee*, *Lotteria*, and *KFC* increased to only four, nine, and 14, respectively. However, by 2009, four years after the introduction of the *Franchise Law*, the numbers of outlets in these systems had increased to 10, 80, and 80 respectively. *Pho 24* and *Trung Nguyen Coffee*, two of the most prominent and successful domestic systems expanding through franchising, currently have about 90 outlets and over 1000 outlets, respectively. Both have also expanded overseas. After a decade of franchising, *Ninomaxx* and *Foci*, two domestic fashion brands, by 2010 had 50 and 33 outlets, respectively. A cake store chain, *Kinh Do Bakery*; a tea restaurant, *Hoa huong duong (Sunflowers)*; and a cane-juice restaurant, *L Thu I lien,* 'Kinh doanh nhuong quyen thuong mai tai Viet Nam se tang 35% [The Sales Growth of Franchising in Vietnam will Increase to 35%]' (2009) <http://dddn.com.vn/2009091007281011cat119/kinh-doanhnhuong-quyen-thuong-mai-tai-viet-nam-se-tang-35.htm>, last accessed 30 July 2012.

Each commenced franchising in the year of enactment of the Franchise Law and by 2010 had 32, 40, and 28 outlets, respectively. A survey of 240 franchisees in fast food, beverage, confectionary, retail store, electronics, fashion, medicine, and mobile phone sectors conducted in 2009, found that 75 percent of the franchisees had been operating since 2006.¹

Although most franchising system outlets in Vietnam are still owned and operated by franchisors, there is a clear trend to system expansion through franchising outlets since the introduction of the Franchise Law. Since 2006, many foreign franchisors have chosen master franchising or direct franchising to access the Vietnam market including Cartridge World, Gloria Jean’s Coffees, Chocolate Graphics (from Australia); Dream Cones (from France); Daiso, Hachi Hachi, and Sarku (from Japan); Big C (from Thailand); Debenhams (from the UK); and Sandler Systems Inc, Hard Rock Coffee, CBTL Franchising, Carl Karcher Enterprises, Cold Stone Creamery, and Bud’s Ice Cream (from the US).

**Substantial Sales Growth and Spread of Franchising over Different Sectors**

The sales growth of the franchise sector has substantially increased over recent years - from US$ 1.5m (1996) to US$ 9m (2005), and is estimated to reach US$ 36.68m in 2010.² According to Euromonitor, the revenue growth rate of the fast food sector in Vietnam - the most popular sector for franchising - was always over 13 percent annually during the period 2005-2010 (from VND 3,338 billion, about US$ 180 million, in 2005 to VND 7,126 billion, about US$ 383 million in 2010).³ In the fast food sector, the three franchisor pioneers KFC, Lotteria, and Jollibee have more than 70 percent market share. The growth rate of Lotteria was 38 percent in 2009 and the average revenue of each of its outlet was VND 700m (US$ 40,000) per month.⁴ On 22 June 2006, consumers queued for the opening of KFC’s first outlet in Hanoi (its 21th outlet in Vietnam) that seats 120 customers.⁵ With the

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success in Vietnam market, such prominent franchisors as KFC, Lotteria, and Jollibee have been expanding their systems in Vietnam\(^1\).

Franchising as method of doing business has been used by both domestic and foreign companies to access a variety of industry sectors. In Vietnam, there are currently at least 16 industry sectors which have utilised franchising with fast food restaurants, retail store and education currently the three most popular sectors. The distribution of franchise systems in industry sectors in Vietnam is indicated by the following chart:

**Figure 4: Distribution of Franchise Systems by Industry Sector**

![Pie chart showing distribution of franchise systems by industry sector.]

Source: Nguyen Ba Binh

5. The Role of the *Franchise Law* in the Development of Franchising in Vietnam

5.1. *The Franchise Law is necessary for the development of franchising*

The introduction of Vietnam’s *Franchise Law* has paved the way for the adoption of a franchising strategy by local and international enterprises. It makes franchising, as a discrete business model, practicable. The experience of Lotteria, Gloria Jean’s Coffees, Trung Nguyen Coffee, and Pho 24 - four prominent fast food/coffee systems operating in Vietnam - is instructive. Because of the *Franchise*

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Law, *Gloria Jean's Coffees* could enter Vietnam through its traditional entry mode - master franchising - an impossible mission under the previous legal regime and one which it would not have attempted. After Vietnam introduced the *Franchise Law*, *Lotteria* quickly registered its system with the Ministry of Industry and Trade and commenced preparations for franchising. *Lotteria* expressly acknowledges that without the *Franchise Law* it could not franchise its system\(^1\). *Trung Nguyen Coffee* is currently standardising its operations in order to upgrade its system from product and trade name franchising to business format franchising which is now possible under the *Franchise Law*. As explained by Mr Dang Le Nguyen Vu, its founder and chairman, *Trung Nguyen Coffee* initially had to "franchise" its outlets through agent contracts without system standard requirements because, in part, it could not rely on laws for protection. The introduction of the *Franchise Law* was a necessary prerequisite for *Trung Nguyen* standardising its outlets to strengthen the development of its brand and to successfully expand overseas. Similarly, Mr Ly Quy Trung, the founder and chairman of *Pho 24*, stated that:

*The Franchise Law gives us more confidence to conduct franchising in Vietnam. It paves a way to easily franchise today and in the future\(^2\).*

**5.2. The Franchise Law is not an exclusive factor for the development of franchising**

Although the introduction of the *Franchise Law* is recognised, acknowledged, and welcomed as a necessary prerequisite for franchising it is apparent that social-cultural, commercial and economic factors influence the adoption of a franchising strategy. The experience of the four prominent systems noted above is outlined below.

*Lotteria*

Unlike the traditional strategy of *Lotteria* in its home country, South Korea, where its expansion is mainly through franchising - 80 percent of its outlets are franchised - *Lotteria* Vietnam currently owns and operates all of its 92 outlets. This is despite Vietnam having introduced the *Franchise Law* in 2006, which legalises franchising expansion and despite *Lotteria* having registered its system with the Ministry of Industry and Trade of Vietnam, which permits it to conduct franchising operations. The introduction of the *Franchise Law* has created the legal environment in which franchising is a legally available option for *Lotteria*, but commercial and cultural factors have to date provided challenges which have

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1. Mr Lee Jang Mook, interview 1 April 2011.
2. Mr Ly Quy Trung, interview 31 March 2011.
prevented Lotteria from adopting a franchise strategy. Mr Lee, Director of Lotteria Vietnam, explained that:

**Potential franchisees in Vietnam do not know the franchise concept. They do not know why they have to buy material from Lotteria, be controlled by Lotteria and pay royalties to Lotteria. These are the essence of franchising. At the present time it is easier to build a successful brand image and reputation for good service, and food quality if all outlets are owned by Lotteria**.

However, Mr Lee accepted that conducting franchising in Vietnam was only a matter of time:

*We have to franchise as it is an easy way to expand our system. For example, in Ho Chi Minh City and Hanoi's downtown the rental of location is very high. We cannot rent all locations we want, although we would like to open many stores in these areas. Therefore, if Vietnamese companies which had or can rent buildings in good places, we can franchise to them. Even in other areas, if the building owners would like to get franchise from Lotteria, we are happy to do that.*

While continuing to expand its system through company owned and managed outlets Lotteria is therefore preparing for franchising. When the local people's perception of the franchise concept is better, and the commercial environment improves, Lotteria will commence a franchising strategy.

**Gloria Jean's Coffee**

Gloria Jean's Coffees entered Vietnam after the introduction of the Franchise Law, in 2007, and immediately pursued a business format franchise strategy. To date, Gloria Jean's Coffees has only six outlets in Vietnam - three of which are owned by Gloria Jean's Coffees Vietnam and three of which are sub-franchised. However, Gloria Jean's Coffees faced difficulties which arose from differences in cultural and social norms. Gloria Jean's Coffees initially applied its system in Vietnam as the same manner as in Australia which led to difficulties in the Vietnamese market. Ms. Nguyen Phi Van - International Marketing Manager at Gloria Jean's Coffees International and former Director of Gloria Jean's Coffees in Vietnam - confirmed that:

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1. Mr Lee Jang Mook, interview 1 April 2011.
2. Mr Lee Jang Mook, interview 1 April 2011.
Franchisees at that time feared that they were applying the franchise system incorrectly so they simply applied in totality the Gloria Jean’s Coffees’ system as it operated in Australia. We did the same. Since 2009, Gloria Jean’s Coffees has adjusted its system for the local market, although the adjustments are not as substantial as those introduced by Lotteria. Almost all aspects of Gloria Jean’s Coffees Vietnam are the same as Gloria Jean’s Coffees in Australia - the home country - from menu to serving style. It offers Arabica coffees which are different to popular local coffees using Robusta beans. Gloria Jean’s Coffees Vietnam also continues to use a self-service system as in Australia which is not readily accepted by Vietnamese consumers. The only major change is in its menu: "We did launch a local version of hot and cold coffee to cater to local needs," said Ms Van.

Although Gloria Jean’s Coffees operates successfully in many countries the closure of several outlets, and the very small number of current outlets, suggest that its expansion in Vietnam through franchising is more problematic. After six years of operation in Vietnam, Gloria Jean’s Coffees still has not yet recouped its investment, and the point of time for its breaking even and becoming profitable is acknowledged by Ms Van to be "unknown." The full business format franchise model relocated from Australia seems not to have operated well in Vietnam’s social-cultural, commercial, economic and legal environment.

Pho 24

Pho 24 embraced a full business format franchise model from the beginning and is recognised as one of Vietnam’s most prominent domestic franchisors. The relationship between this company and its franchisees nevertheless resembles one of partners in a joint venture rather than a pure business format franchise relationship. Pho 24 has invested in each of its franchised outlets in Vietnam and is a part owner of each franchised outlet. The legal, social-cultural, commercial and economic context of Vietnam has influenced this choice of model. Despite the introduction of the Franchise Law legal enforcement is still weak and Mr Trung is firmly of the

3. Dung, above n 1.
opinion that he cannot rely on the law for protection of his system and enforcement of his rights. Being a partner with his franchisees in their outlets is the compromise that the owner of Pho 24 has adopted to control his system.

In addition to regulatory issues, cultural, commercial and economic factors have had a significant influence on the expansion strategy of Pho 24. Unlike the traditional model of franchising for relatively small and unsophisticated concepts in Australia - the so-called "mom and pop" model comprising a husband and wife partnership - in Vietnam almost all franchisees of Pho 24 are established and successful businessmen. In Vietnam, there are many "mom and pop" restaurants but they are rarely franchised outlets. Pho 24 does not have any "mom and pop" franchisees in Vietnam. When asked why he did not franchise to individuals entering business for the first time Mr Trung said that it was not easy to find such franchisees under the current cultural, commercial and economic context of Vietnam even among his own employees.

Unlike the position in developed countries where franchisees in small systems and unsophisticated concepts are often owner-operators who are usually required to dedicate all their time to their franchised outlets, Pho 24 franchisees are owner-investors. Running a franchised outlet is usually only a part of the franchisee's multiple business lines and the franchisee can spend only a limited time in the franchised outlets. The franchised outlets are operated by a manager who is employed and directed by the franchisees. However, the franchisees and their managers rarely have day-to-day contact. For example, a Korean franchisee of Pho 24 with five outlets in Vietnam visits only two outlets to look around and talk with the managers every week. Moreover, Pho 24 franchisees tend to reduce costs, which eventually results in lower quality of products and service than that demanded by system standards. Mr Trung has acknowledged that:

The negative thing about franchised stores is the quality of the food. I am concerned most of the complaints from the customers are with the franchised stores.

The relationship between Pho 24 and its franchisees is also less personal and quite different to the franchisor-franchisee relationship in western countries where

1. Mr Ly Quy Trung, interview 31 March 2011.
3. ibid.
4. ibid.
franchising is often described as a "commercial marriage"\(^1\). Despite trying to regularly keep personal contact with the franchisees, Mr Trung commented that he knew little about the families of the franchisees as this could harm his business. He has emphasised that:

*In Vietnam it is quite sensitive. If you go to too much into the relationship then you cannot manage. You can’t be good friends or they don’t listen to you. Work relationship but not friends; if it becomes like friends then I cannot work*.\(^2\)

*Pho 24* invests in its franchise units and becomes a part owner to be in a position to better control system standard and uniformity among its franchised outlets. Mr Trung has stated that:

*I adjusted (the system) quite a lot to match the Vietnam context. For example, when I started to franchise I didn’t want to just sell the franchise but (I wanted) to sell the franchise plus my shares as a shareholder. The concept was at least 30 percent of investment from Pho 24 to any franchisee store.... that way I feel safer, I feel I have better control of the franchisee*.\(^3\)

This strategy has been confirmed by *Pho 24’s* Human Resource Manager:

*We need control and so that is why we have the voice of the franchisee and the voice of the partner. That is why [Mr Ly Quy Trung] wants to control the company*.\(^4\)

**Trung Nguyen Coffee**

*Trung Nguyen Coffee*, unlike *Gloria Jean’s Coffees* and *Pho 24*, has chosen an unsophisticated product and trade name franchise model to expand its system. Through applying this strategy, *Trung Nguyen Coffee* has successfully expanded its system throughout Vietnam. The *Trung Nguyen Coffee* model is a good fit with Vietnam’s environmental conditions - social-cultural, commercial, economic, and legal.

For a long period - the decade 1998 to 2008 - *Trung Nguyen Coffee* conducted a form of product and trade name franchising to take advantage of franchisees’ capital and human resources to popularise its brand name and to sell its coffee products. Moreover, standardisation of its system was neither necessary nor suitable having regard to Vietnam’s environment at that time. The *Doi Moi* economic reforms - which moved Vietnam from a centrally planning economy to a socialist

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2. Frazer and Merrilees, above n 52.
3. *ibid*.
4. *ibid*.

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oriented market economy - were then very new and intellectual property and franchising were not well understood by the general public or by prospective entrepreneurs. The legal framework did not consider franchising as a discrete economic organisation and, under that legal framework, Trung Nguyen Coffee had to expand its system through agent contracts rather than through franchise agreements. Requiring standardisation of the system under that context was impracticable. In Mr Vu’s words:

It is impractical to require the system’s standard when there was not any standard concept in the mind of people. Therefore, during that time, I only needed the same signboard appearing in all outlets of Trung Nguyen Coffee.

In the first decade of franchising, Trung Nguyen Coffee therefore focused only on expanding its outlets without standardising its system. It did not copy the familiar western model but adapted it to fit Vietnam’s context. Its outlets have been developed in four levels, and franchising is conducted in a different way at each level with different standards, different formats and different franchisee and franchisor obligations. At the first two levels, Trung Nguyen Coffee utilises only product and trade name franchising, and begins using business format franchising with increasing system standardisation only at Level 3. The legal, cultural, commercial and economic context of Vietnam has influenced this franchise strategy adjustment: awareness of intellectual property and franchising is still low and franchising standards and compliance requirements are not yet highly recognised or appreciated by local businesses. Since 2006, there has been a franchise-specific law, but legal implementation is still weak and it is difficult to rely on the law for the protection of Trung Nguyen Coffee’s franchise system. Although Vietnamese consumers’ awareness of brand names and franchising is much better than before, the recruitment of suitable potential franchisees remains a very significant challenge. The flexibility of Trung Nguyen Coffee’s franchising strategy helps it to overcome such difficulties.

Since 2008, Trung Nguyen Coffee has introduced a new franchise model to coexist with its original model. It has re-engineered its system to introduce standards and uniformity on a business format franchise model. Trung Nguyen Coffee has standardised all aspects of its new coffee outlets from menu to outlet design. This is a preparatory step to conducting business format franchising now that the Franchise Law facilitates franchising. However, all of the new domestic outlets have been company owned and operated outlets rather than franchised.

1. Mr Dang Le Nguyen Vu, interview 2 April 2011.
Today, although the *Franchise Law* has paved a way for *Trung Nguyen Coffee* to conduct franchising as a discrete business method, its new franchise strategy requires a high level of standardisation, which is currently easier to control if the outlets are owned and managed by *Trung Nguyen Coffee* itself.

6. Conclusion

In a 2001 Report the OECD noted that:

Entrepreneurship and business activities are shaped not only by markets, but also by regulatory and administrative environments established by governments.¹

The Vietnamese experience in relation to franchising supports this proposition: franchising was not possible until legal reform in the form of the *Franchise Law* introduced the appropriate environment for its operation. However the Vietnamese experience also confirms that a range of other environmental factors - cultural, social, economic and commercial in addition to weak legal enforcement - are highly influential in the adoption of a franchising strategy. Franchising can now be practiced in Vietnam but a range of extra-legal factors currently constrain its development. The *Franchise Law* nevertheless puts in place the necessary regulatory infrastructure for the future development of the Vietnam franchise sector for the ultimate benefit not only of Vietnamese entrepreneurs and consumers but for the wider society through facilitating international integration and supporting sustainable SME development.

Bibliography


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