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CARPENTER TAN handicrafts Co., Ltd.: FRANCHISEE SATISFACTION

Yibo Lyu, Shaojie Han, Wei Liu, Jingqin Su, and Qi Zhang wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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Qi Zhang owned two franchised stores of Carpenter Tan Handicrafts Co., Ltd. (Carpenter Tan) in Panjin City, Liaoning Province, China. It was November 5, 2016, and she had just finished a long discussion with Hongbing Liu, the general manager of Carpenter Tan, about whether she should set up a third franchised store to continue to improve the sales of wooden crafts in Panjin. When her first franchised store was set up in 2012, she had been excited by and satisfied with Carpenter Tan’s franchise model. However, she had later felt that this franchise model was restricting her development, especially after her second franchised store was set up in 2014. Despite her concerns, Carpenter Tan suggested that she open a third franchised store in Panjin, where the wooden crafts market was close to saturation. If she did as requested, the third franchised store might face a high risk of losing money. Zhang—who had become very dissatisfied with Carpenter Tan’s franchise model—faced a tough choice about whether she should set up a third franchised store.

ZHANG’S BACKGROUND

Zhang majored in petroleum engineering at a famous university in China and graduated in 2010. She then joined the Liaohe oilfield of CNPC (China National Petroleum Corporation), a large, state-owned oil enterprise, in Panjin City. Compared with jobs in private companies, this job in a state-owned enterprise was comfortable and its income was stable. However, its monotony and inflexible work environment were insufferable for Zhang. Moreover, she did not feel it would help her career. Hence, after a consultation with her husband, she decided to resign from the job and start her own business at the end of 2011. Through this decision, she expected to gain a sense of independence and achievement in her business life and, more importantly, raise her income.

However, starting her own business was full of risks and challenges for Zhang. First, as a young woman, she did not have many savings, so she could not put too much money into the business. Second, she had majored in petroleum engineering at university and had no experience in business operations. Third, she was recently married and did not want to jeopardize her family life. In sum, it was important for Zhang to find a business that suited her situation and personal interests.

**WOODEN CRAFTS RETAIL AND MARKET IN PANJIN**

The term “wooden crafts” referred to a variety of machined or handmade wooden objects.[[1]](#footnote-1) Wooden crafts, such as handmade wooden combs and hairpins, were both artistic and practical. On one hand, most of the wooden crafts in Panjin were handmade by experienced handicraft designers and were finely crafted. Therefore, these wooden crafts could be used as interior decorations or as medium- or high-end gifts. On the other hand, these wooden crafts were used in daily life. For example, wooden combs could be used to alleviate work pressure, in addition to tending to hair—in traditional Chinese medicine, it was said that combing hair with a wooden comb could promote blood flow in the brain and alleviate work fatigue. Overall, these artistic and practical wooden crafts were popular with middle- and high-end customers in China.

With the increase in household incomes in China, there was a growing demand for wooden crafts.[[2]](#footnote-2) In particular, residents in Panjin had a high consumption capacity and strong demand for wooden crafts. Panjin was located in the mid-south of Liaoning Province, and its total population was 1.4 million.[[3]](#footnote-3) Its per capita gross domestic product (GDP) had been second in Liaoning Province since 2010, and in 2015, the per capita GDP reached $14,156.[[4]](#footnote-4) At the same time, Panjin was a famous Chinese tourist city with a beautiful natural landscape and lots of scenic tourist spots.[[5]](#footnote-5) Thus, a large number of tourists visiting Panjin could be the target customers of craftspeople. To sum up, wooden crafts offered good market prospects in Panjin.

**CARPENTER TAN AND ITS FRANCHISE MODEL**

Carpenter Tan Handicrafts Co., Ltd., a leader in the wooden crafts industry in China, was founded in 1997. In 2016, Carpenter Tan possessed a modern production factory covering an area of 54,000 square metres in Chongqing City, and developed into a professional company undertaking the production and sales of wooden combs, mirrors, hairpins, and other wooden crafts. During its development, it won many prizes. Being an ISO 9001:2000 certified company,[[6]](#footnote-6) Carpenter Tan was named among the “2006–2007 Top Ten Franchise Brands of Chinese Retail” by the China Chain Store & Franchise Association in April 2007. On December 29, 2009, Carpenter Tan was listed on the main board of the Hong Kong Stock Exchange.[[7]](#footnote-7) Carpenter Tan started its move toward being the world’s top brand in the wooden crafts industry with the help of the financial listing. In January 2014, Carpenter Tan was selected among the “2014 Forbes China Top 100 High-Potential Listed Enterprises.”[[8]](#footnote-8) In 2016, it was also selected among “China’s Top 100 Brands” for the first time.[[9]](#footnote-9)

Carpenter Tan’s success was highly related to the establishment of its franchise model. Since March 7, 1998, franchising had been Carpenter Tan’s dominant strategy for expanding in the market. In 2001, the number of its franchised stores exceeded 100, and the number doubled the next year. By December 31, 2016, Carpenter Tan owned 1,281 franchised stores in China and three franchised stores overseas.[[10]](#footnote-10)

Carpenter Tan promoted the development of its franchise model in various ways. In 2000, it introduced a visual identity system to ensure that the appearance of each franchised store was consistent. In 2001, its *Franchised Store Standard Manual* was put into practice to promote the standard operations of franchised stores. In 2002, Carpenter Tan held the first national franchisee annual meeting to enhance exchanges and communication with franchisees. In 2008, the *Handbook of Carpenter Tan Culture* was established to enrich the cultural connotation of products and create a high-end brand positioning in the wooden crafts industry. Meanwhile, Carpenter Tan constructed logistics channels to accelerate the circulation of products and reduce the operating costs of both itself and its franchisees. Carpenter Tan had formed its standard franchise model to provide branding, products, standardized training, and so on to franchisees. With the help of Carpenter Tan’s franchise model, many franchisees could set up their own franchised stores. Zhang was one of them.

ZHANG’S FIRST FRANCHISED STORE

Based on the good market prospects in Panjin and her trust in Carpenter Tan, Zhang decided to set up her first franchised store. In June 2012, she opened the store by following the standard franchising process (see Exhibit 1). She found that Carpenter Tan’s franchise model fit her requirements well.

Store’s Cost and Profitability

The store’s annual rent was ¥60,000–¥100,000,[[11]](#footnote-11) and its decorating fee was about ¥35,000–¥40,000. In addition, the franchise fee was ¥10,000, and the first purchase was not to be less than ¥35,000. Overall, the total investment was about ¥140,000–¥185,000, which was quite acceptable for Zhang. Generally, the product profit margin ranged between 40 and 60 per cent. According to the average level of total profits of Carpenter Tan’s franchised stores, Zhang’s store profit would be twice her salary at the Liaohe oilfield.

Brand and Products

After years of brand management, Carpenter Tan had become a reliable brand to customers—especially high-end customers. As a leader in the wooden crafts industry in China, Carpenter Tan provided exquisite, reliable quality products such as combs, mirrors, and hairpins. Moreover, all products were supplied and distributed directly by Carpenter Tan, which guaranteed the products’ quality and distribution efficiency.

Store Location and Decoration

Carpenter Tan provided a series of guidance services to its franchisees during the process of identifying store locations and decorating stores. It provided Zhang with three basic principles for identifying her first store’s location. It should be on the street of a business centre, close to a place where people gathered, with convenient public transportation. Carpenter Tan sent its professional staff to Panjin to help Zhang choose an appropriate location for her first store. Furthermore, Carpenter Tan assigned its decorating team to decorate Zhang’s franchised store to guarantee that all franchised stores had a uniform exterior and interior image.

Professional **Training**

Zhang lacked product knowledge and professional business experience. Therefore, Carpenter Tan provided professional training on product stocks, sales, and advertising using the *Franchised Store Manual*; it also provided professional training on product function and display using the *Product Manual*.

**Risk Security Mechanism**

Carpenter Tan allowed franchisees to replace unsalable products. Franchisees that would not continue their contracts could return products that had been in stock for less than one year. To Zhang, who had no experience, these policies greatly reduced her risks.

After her first store launched, Zhang worked hard on everything to do with the store. During the daily process of product purchasing, displaying, promoting, and advertising, she gradually became familiar with product materials, characteristics, and functions. With great effort, she earned her entire investment back after half a year (see Exhibit 2). Zhang knew in her heart that she could not have been so rapidly successful without Carpenter Tan’s mature franchising model.

ZHANG’S SECOND FRANCHISED STORE

In January 2013, Zhang found that her franchised store suffered a growth bottleneck after its revenue had grown at a rapid pace for six months (see Exhibit 2). Although she promoted products through the local newspaper and on television during the Spring Festival—the most important festival in China—the revenue nonetheless stopped growing.

In order to raise her personal income, Zhang began to consider setting up a second franchised store in Panjin. Carpenter Tan provided a preferential policy whereby the franchise fee would be halved if a franchisee opened a second franchised store in the same city. Therefore, in May 2014, Zhang’s second franchised store opened. Ten months later, she earned back the entire investment of the new store.

In August 2015, when the revenue of her second store met a bottleneck, Zhang tried to find new ways to promote the revenue for her two stores. Although she considered several methods, none of them could succeed because of the restrictions imposed by Carpenter Tan’s franchise model.

*Method 1*: *Product discounts to attract more customers*. Carpenter Tan insisted on national uniform prices, and discounts were not permitted under its franchise model. This pricing policy was also applied to its regular customers, who were expecting preferential prices. What was worse, franchisees were not able to promote sales during holidays and festivals through product discounts.

*Method 2: Suggesting that Carpenter Tan perform advertising through TV, Internet, etc*. As a franchisor, Carpenter Tan insisted on only a word-of-mouth advertising strategy and refused to fund other strategies. If the franchisees wanted to advertise on television or in newspapers, they had to pay for the promotion by themselves. However, in the age of the internet and widespread data and information, the word-of-mouth advertising strategy was not effective in promoting sales volume.

*Method 3: Reducing operating costs*. Because Zhang did not have much money, maintaining control of operating costs was always the key to her franchised stores. Yet she could not further reduce operating costs, because Carpenter Tan transferred its own operating costs to franchisees. For example, although Carpenter Tan insisted on a mere word-of-mouth advertising strategy, it required its franchisees to use advertisements on TV, in newspapers, and so on, which transferred Carpenter Tan’s advertising costs to franchisees.

*Method 4: Adding product categories and establishing a product portfolio*. Carpenter Tan strictly forbade products of other brands to be sold in its franchised stores. However, Carpenter Tan’s product categories were limited to combs, mirrors, and hairpins, which made it difficult to meet customers’ diverse needs.

Zhang felt that the franchise model had greatly restricted the further development of her business.

**ZHANG’S THIRD FRANCHISED STORE—TOUGH CHOICE**

Since 2015, Zhang had felt that the franchise model greatly limited the improvement of her business and the revenue growth of her two franchised stores. However, the two stores remained profitable, so she did not give them up. On November 5, 2016, when Carpenter Tan general manager Liu visited Panjin, he suggested that Zhang set up a third franchised store in Panjin. Although her first franchised store was still profitable, the profit was clearly falling (see Exhibits 3 and 4). This was also true for her second franchised store. Moreover, the two franchised stores were close to saturating the market in Panjin, a second-tier city in China with a population of only about 1.4 million. If a third franchised store was set up, there was a high chance that it would lose money or, even worse, encroach on the market share of the existing stores. However, if she refused to launch the third store, Carpenter Tan would introduce new franchisees in Panjin. The new franchisees could seize the market share in Panjin with no additional marketing cost considering Zhang’s previous market development efforts.

Zhang wondered, “Should I set up the third store?” This was a tough choice. Another idea came to mind: “Now that the franchise model has already restricted my business, it might be a good choice to quit this franchise model and try another business.”

EXHIBIT 1: Carpenter Tan FRANCHISE PROCESS

Consultation

Online requisition

Qualification assessment

Interview

① Visit sample store ② Negotiation

③ Introduce franchise contract ④ Sign franchise contract

Identifying store’s location

Decorating the store

Trial operation

Starting business

Franchising fee

Note: During the online requisition phase, potential franchisees provided their name, educational background, work experience, and operating plans for the franchised store to Carpenter Tan as a part of the franchisee qualification assessment. In the trail operation phase, the franchisee simulated operation of the franchised store for a period of two days prior to the official opening. The trail operation phase helped the franchisee understand the operation process.

Source: Compiled by authors from an interview with Zhang, January 15, 2017.

EXHIBIT 2: REVENUE OF ZHANG’S FIRST fRANCHISED STORE by month from JUNE 2012 to JUNE 2013 (in ¥ THousand)

¥ = CNY = Chinese yuan/renminbi; US$1 = ¥6.3396 on June 1, 2012.

Source: Created by authors using data from Zhang.

EXHIBIT 3: PROFIT OF ZHANG’S FIRST FRANCHISED STORE by from JUnE 2012 to DECEMBER 2016 (in ¥ THousand)

¥ = CNY = Chinese yuan/renminbi; US$1 = ¥6.3396 on June 1, 2012.

Source: Created by authors using data from Zhang.

EXHIBIT 4: FINAnCIAL STATEMENTS for ZHANG’S FIRST FRANCHISED STORE

for six MONTHS (¥)

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Item | **2012** | **2013** | **2013** | **2014** | **2014** | **2015** | **2015** | **2016** | **2016** |
| 7–12 | 1–6 | 7–12 | 1–6 | 7–12 | 1–6 | 7–12 | 1–6 | 7–12 |
| Revenue | 607,821 | 1,073,253 | 1,095,302 | 1,112,182 | 1,088,004 | 1,026,950 | 896,403 | 760,541 | 748,804 |
| Cost of sales | 292,610 | 670,224 | 683,002 | 690,105 | 681,460 | 638,746 | 535,546 | 429,488 | 424,725 |
| Selling and distribution expenses | 103,682 | 110,850 | 114,840 | 120,432 | 123,432 | 124,845 | 125,695 | 126,648 | 128,680 |
| General and administrative expenses | 42,050 | 43,540 | 43,589 | 44,856 | 44,892 | 45,843 | 48,940 | 48,865 | 49,752 |
| Financial expenses, net | 334 | 543 | 467 | 643 | 587 | 578 | 487 | 632 | 612 |
| Operating profit | 169,145 | 248,096 | 253,404 | 256,146 | 237,633 | 216,938 | 185,735 | 154,908 | 145,035 |
| Income tax expenses | 5,074 | 7,443 | 7,602 | 7,684 | 7,129 | 6,508 | 5,572 | 4,647 | 4,351 |
| Net profit | 164,071 | 240,653 | 245,802 | 248,462 | 230,504 | 210,430 | 180,163 | 150,261 | 140,684 |

Note: “1–6” refers to January to June, while “7–12” refers to July to December.

Source: Created by authors using data from Zhang.

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11. ¥ = CNY = Chinese yuan/renminbi; US$1 = ¥6.3396 on June 1, 2012. [↑](#footnote-ref-11)