



Franchising in Ireland Survey 2004

The Definitive Guide to the Irish
Franchise Industry



CONTENTS

3 The outlook is positive

Introduction by Cathal Muckian.

4 Franchising in Ireland

There is more information available now than ever when it comes to franchising.

8 Follow Me Up to Carlow

Case Study 1: Dominos Pizza

10 Full of Eastern Promise

Case Study 2: The Lemongrass Restaurants

12 Franchising Companies in Ireland

Franchising companies & contact details

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Cathal Muckian

The outlook is positive

BANK OF IRELAND BUSINESS BANKING recognises the importance and development potential of franchising in Ireland. The sector has become an integral part of our economy and has experienced exceptional growth over the last two years. Franchising is one of the new enterprise sectors, which continues to drive the development of our economy contributing to employment, new and innovative products for consumers and general wealth creation.

The statistics in this year's survey are testament to the importance of franchising. The expansion is indicative of the buoyancy of the sector and presents enormous opportunity, as there is still scope for new and different franchise systems to enter the Irish market.

At Bank of Ireland Business Banking we understand the demand and appetite for expansion, which is driving the growth of the

sector. We have responded by launching a €100m Franchising Fund designed to assist the expansion of franchise companies and to facilitate people who wish to start or expand their own businesses through franchising.

The outlook for franchising is positive. It is a growth industry that has developed rapidly in Ireland over the past number of years. This growth will continue through existing franchises and through new entrants to the market. Bank of Ireland Business Banking is a proud sponsor of this year's Irish Franchise Survey and we look forward to supporting this valuable sector for many years to come.

Cathal Muckian Director of Business Banking

Franchising in Ireland

When this series of studies was started, franchising was considered an exotic or very different form of business development. To identify a franchise opportunity, people had to travel to franchise exhibitions in the United States or the United Kingdom. For the brave few that signed franchise agreements at that time there was a lack of information on the subject of franchising. This series of studies and associated guidebooks combined with the work of the Irish Franchise Association has meant that a body of franchise information is now available to the person assessing a franchise opportunity. These resources will help to de-mystify the topic and in a small way contribute to the future growth of this industry.

In Ireland, as with the rest of the world, the growth of franchising is running parallel to the growth of the service economy. As the service economy becomes an increasingly important creator of wealth, franchising, itself a service, and concentrated exclusively in this sector, is set for continued growth.

We can trace the growth of franchising back to one fundamental of business, namely, competitive advantage. Franchised businesses are successful because they have a competitive advantage over single unit companies. This advantage comes from the following factors.

1. Franchised businesses are tried, tested and evolving business concepts.

The franchisee is part of a more dynamic group within a franchise network than the owner manager who

operates alone. A flow of new products or ideas should come from the franchisor but may as easily come from one of the franchisees.

2. Costs.

The franchise system has the scale to purchase goods at more competitive prices, enabling franchisees to compete on price with single unit operators.

3. Branding.

The pooling of an advertising levy has provided franchisees with national advertising implemented by professional advertising agencies. This branding has helped to differentiate the franchise offering and help build a share of mind for individual franchise companies.

Attractiveness to shopping centres.

Because of customer recognition of franchise brands, such as Mango, O'Briens and Pizza Hut, a franchise is an attractive tenant for a shopping centre owner as is shown by the high percentage of franchised businesses operating in new shopping centres in our urban areas.

All the above factors explain the continuous growth of this method of business expansion. For the consumer it has resulted in an ever increasing array of services. Indeed, it has been said that in the United States new additions to the franchise sector will mirror the changes taking place in our society as is evidenced today by franchises offering botox treatment or the start of 'low-carb' restaurants.

INTERNATIONAL COMPARISONS

To put this study and its findings in context, it is important to look at where franchising has evolved in other



economies. A recent study commissioned by the International Franchise Association in Washington was conducted by PricewaterhouseCoopers. This exhaustive study examined the economic impact of franchising in the United States and the following is its main finding.

"Franchised businesses operated 767,483 establishments in the United States in 2001 counting both establishments owned by franchisees and establishments owned by franchisors. They provided 9,797,117 jobs, met a \$229.1 billion payroll and produced \$624.6 billion output. To indicate economic size in a different way, franchise businesses employed about the same number of people in 2001 as did all manufacturers of durable goods, such as computers, cars, trucks, planes"

In Britain the Nat West/B.F.A. franchise survey provides the following comparison.

The total number of franchisors in Britain has now risen to 695, employing a total of 330,000 people. The turnover of the industry in Britain is £9.65 billion (sterling).

From the above, one can see that franchising is a major contributor to growth in these economies.

TABLE 1

TURNOVER OF FRANCHISE SYSTEMS IN IRELAND (€) 1995 - 2003

Survey	1995	1997	1999	2001	2003
Turnover	€0.256	€0.397	€0.571	€1.02bn	€1.272bn*
Change on previous survey	+ 62%	+ 55%	+ 43%	+79%	+24%

* Note (a) Turnover figures do not include sales by the retail symbol groups.



TABLE 2

EMPLOYMENT IN THE FRANCHISE SECTOR IN IRELAND 1995 - 2003

Survey	1995	1997	1999	2001	2003
Employment	4,900	7,400	9,600	14,400	17,890
% Change	+48%	+ 51%	+30%	+ 50%	+ 24%

ALTHOUGH 13% OF FRANCHISORS ARE PREPARED TO NEGOTIATE ON FEES ALL WILL WANT TO BE PAID OTHERWISE THE SYSTEM WILL FALL APART.

THE ECONOMIC IMPACT OF FRANCHISING IN IRELAND

Franchising continues to grow in Ireland although at a slower pace than has happened over the past decade.

Although the rate of growth in Ireland is slower, it compares with an annual growth in Britain in 2003 of 2%. However, with 695 franchise systems in Britain compared with our 201 there is significant room for further growth in the future as new and different franchises enter the Irish market.

Research in the United States has shown that in times of employment downturn or uncertainty, the enquiries to franchise companies go up as people look to franchising as a means of starting their own business.

The turnover figures (Table 1) do not include the turnover of retail outlets such as Spar, Supervalu or Centra. The turnover of these organisations combined would dwarf the turnover of the business format industry.

EMPLOYMENT

At a time of continuous threats to employment growth within the more traditional sectors of agriculture or manufacturing, it is heartening that franchising continues to grow the number of people in full-time employment. (Table 2)

It is recognised that franchising has a significant part-time element in it and in keeping with previous surveys, we have counted two part-time jobs as one full-time job.

TABLE 3

FRANCHISE SYSTEMS

Country of Origin of Franchises in Ireland	
USA	39
UK	31
Ireland	11
Others	19

It is important to note that all employment in the franchise sector is created without grant-aid, special incentives or any government time or involvement. It is a sector which is delivering net increases at no cost to the state or the taxpayer.

TURNOVER PER EMPLOYEE

The turnover per employee, a measure of both efficiency and profitability, has remained relatively static over the period with a marginal rise from €70,000 in 2001 to €71,000 at the end of 2003

ORIGIN OF FRANCHISES

One of the significant findings in this survey is the continuing small percentage of Irish based franchises. This situation will not change unless there is a positive approach to nurture and development of indigenous Irish Franchises. The traditional retail outlet, restaurant or coffee shop can become an export earner through adopting the franchise model. The work of the U.S. Department of Commerce has been a significant force in the international drive of U.S. based franchises. In Ireland, the excellent work of the U.S. embassy has been a significant source of new U.S. franchise concepts to Ireland. (Table 3)

COST OF FRANCHISING

Is it more expensive to start a business through franchising? The short answer is yes, but if it means that with the back up, support and experience of the franchisor, you have a better chance of success then it can ultimately prove a much cheaper method.

How many small business owners have stated after a few years "If I only knew when I was starting what I know now I would have saved myself a lot of money." When you pay franchise fees, you are buying the experience of the franchisor and other franchisees as part of the franchise package. (Table 4)

TABLE 4

BREAKDOWN OF TYPICAL FRANCHISE COSTS

	2003	2001	1999	1995
Fee	Average	Average	Average	Average
Initial franchise fee	€22,200	€21,000	€14,000	€11,881
Initial working capital	€40,280	€33,000	€25,395	€18,006
Total investment cost	€222,000	€160,000	€89,000	€81,545
Fixed annual fee	€7,570	€4,200	€2,666	€3,089
Management Services Fee (MSF) / Royalty Fee	7.4%	7.1%	6.5%	7%
Advertising levy	2.6%	2%	2.9%	2.5%

INITIAL FEES

If you are assessing different franchise opportunities, you should expect to pay an initial fee. Nine percent of all the franchises do not charge an initial fee but you will find that they make this up either in higher ongoing fees or through exclusive purchase agreements.

The increase of initial fee over the period from €21,000 to €22,700 has not been significant. If you are quoted very high up front fees from a franchisor that appear to be out of line with the industry average, it is important that you assess what the franchisor is bringing for the fee.

The above initial fee is for a single unit and one would expect to pay a significantly higher fee for what is called a master licence agreement. Such an agreement may give you the rights to the whole of Ireland with the right to sub franchise.

INITIAL WORKING CAPITAL

The average initial working capital at

start-up is €40,280. Some job franchises indicate very low initial working capital but do not incorporate the salary or wage of the owner as part of it. It is important to factor this into your calculations, as you will have to survive and pay yourself for the initial start-up phase. Well known franchise brands will have the benefit of early customer recognition which, when combined with the promotional and marketing support at launch, provides the franchisee with an earlier income stream than may occur if starting a business on their own.

TOTAL INVESTMENT COST

The total investment cost will be indicated by each franchisor. This figure will incorporate both the initial fee and working capital detailed above. It is important to note that this is an average figure and you can find a job franchise for as low as €30,000 - €40,000. At the other end a full service restaurant with bar or a

hotel franchise will cost you significantly more than the average. One of the critical aspects to assess at an early stage is what franchise type will match your own resources and borrowing capacity. The total investment cost should be ascertained at an early stage to save you wasting time researching a franchise opportunity you cannot afford.

CONTINUING FEES

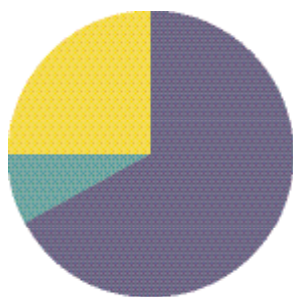
There are three different ongoing fees in franchising. A fixed annual fee, the management services fee or royalty and the advertising levy. You will tend not to pay all of these but rather a combination of two.

FIXED ANNUAL FEE

The fixed annual fee is a fee paid by the franchisee to the franchisor irrespective of turnover. On one hand, it puts pressure on the franchisee to earn minimum targets and on the other hand can act as an incentive to maximise revenue as no fees are paid over and above the fixed fee. The average fixed fee has increased from €4,200 to €7,570 per annum over the period. Where the franchise operates a fixed fee, it is critical that this is not too high for you to pay it and still earn a good return on your investment. At the end of 2003, 22% of franchises offered a fixed fee system.

MANAGEMENT SERVICE FEE/ROYALTY

The MSF or royalty is a variable charge and is a percentage of turnover net VAT. The average fee in Ireland has increased slightly from 7.1% to 7.4%. You do not pay both a fixed fee and royalty. The majority of franchisors (60%) opted for the



Method of Payment

- Monthly **67%**
- Weekly **8%**
- Quarterly / Lump sum **25%**



Location of Training

- Ireland Only **41%**
- Overseas Only **22%**
- Combination Ireland/Overseas **37%**



Duration of Training

- 2 weeks **49%**
- 2-4 weeks **26%**
- 1 months + **25%**
- Total 100%**

royalty method of fee. The balance of 18% has neither a fixed fee nor royalty but have exclusive purchase agreements. In these franchises, the franchisor derives income from supply of product to their franchisees. It is noteworthy that 13% of franchises said that fees are not negotiable.

ADVERTISING LEVY

The advertising levy on all franchises is a feature of franchising. This pooling of resources to build the brand is critical for the success of everyone within the system.

The average levy in Ireland is 2.6%. Only 65% of franchises in Ireland charge an advertising levy whereas in the United States 72% charge a levy. More significantly, the levy in the U.S. is close to 5%, reflecting the importance of brand development in the market. The combination of the advertising levy and royalty is 10% which is in line with the U.S.

PAYMENT OF FEES

Although 13% of franchisors are prepared to negotiate on fees, all will want to be paid, otherwise the system will fall apart.

THE FRANCHISE AGREEMENT

All of the franchises that are considered business format franchises must have a franchise agreement. This differentiates franchising from a traditional business start-up in that the franchisee enters into a legally binding agreement with the franchisor. Essentially you are going into business in partnership with the franchisor and, like any business partnership, you should be comfortable with the terms and conditions at the outset. Trying to re-negotiate the agreement after six months is not recommended. It is better to get professional advice at the start.

NEGOTIATION

The fundamentals of a franchise agreement will not be negotiated away by a franchisor. That does not mean that negotiation will not take place. 13% have indicated that they would negotiate on fees. Like any negotiations, it will depend on what you are bringing to the partnership. If you have significant resources or own a prime retail space, you will find that franchisors are business people and will want to work out a reasonable deal with you.

DURATION

Franchisors offering franchise agreements under 5 years are now the exception.

Given that the average total investment is €222,000 it is reasonable to expect the terms of the franchise agreements to reflect the scale of the investments. If you are to make a significant investment in a franchise system, it is reasonable that the duration of the agreement provides you with the opportunity to get a return on this investment. The average term of franchise agreements in Ireland is now 9.62 years, up from 8.7 in the last survey. It is still shorter than the U.S. where the average length of the initial term has remained a fairly constant 10.29 years.

TERRITORY

All potential franchisees seek exclusive territories but our findings show that these

to territory. Fifty-six per cent of franchisors now have performance clauses. The franchisor will have expectations of turnover in a particular catchment area based on his/her experience at similar locations in the network.

TRAINING

A key aspect of the franchise business is the quality of the initial and ongoing training. A potential franchisee should talk to existing franchisees in the franchise system to assess the level, quantity and quality of training. One hundred percent of franchisors provide training and indeed a franchise would not qualify as a franchise if training was not built into its franchisee development process.



FOR THE BRAVE FEW THAT SIGNED FRANCHISE AGREEMENTS AT THAT TIME THERE WAS A LACK OF INFORMATION ON THE SUBJECT OF FRANCHISING.

are not always available. Sixty-seven per cent of franchisors will provide an exclusive territory with 33% not offering it. There is a slight increase in franchisors not offering exclusive territories from 30% to 33%. However, it is not in the franchisors interest to open too many units in an area resulting in the poor performance or closure of one of the franchisees. One of the big changes in this area from the first survey is the use of county boundaries. In 2003, only 12% of franchisors referred to county boundaries when settling territories, whereas in our first survey, the county boundary was extensively used in setting the territories.

PERFORMANCE CLAUSE

The franchise agreement does increasingly contain performance clauses and this section of the agreement is not unrelated

TRAINING LOCATION

The location of the training is an important factor to be assessed. The arrival of a number of Australian franchises in Ireland illustrates the cost and time implications of undertaking training in overseas locations (see graph on page 6).

OPERATIONS MANUAL

The operations manual is the reference point for the franchisee, and should be up-dated by the franchisor on a regular basis. Ninety-six per cent of franchisors provide an operations manual of which 42% provide an online version of the manual. One would expect that over time all franchises would offer online versions of their manual.

Follow Me Up to Carlow

When a couple of young high flyers in the fast food business decided to apply their experience and skills to managing their own outlets, they received welcome support from their former employer. Now established in Carlow and Cork, Cathal McDonnell and Serge Jolondovschi are applying the principles of customer service and investment in staff training to the competitive world of pizza delivery, writes **Paul Golden**.

The U.S. founded Dominos Pizza is a world leader in pizza delivery, operating a network of company-owned and franchise-owned stores around the world which employ in excess of 140,000 people. Last year the company delivered 400m pizzas from more than 7,000 stores (2,000 of which are located in more than 60 countries outside the U.S.).

Employees with at least one year's service as a store manager have the opportunity to make the leap into

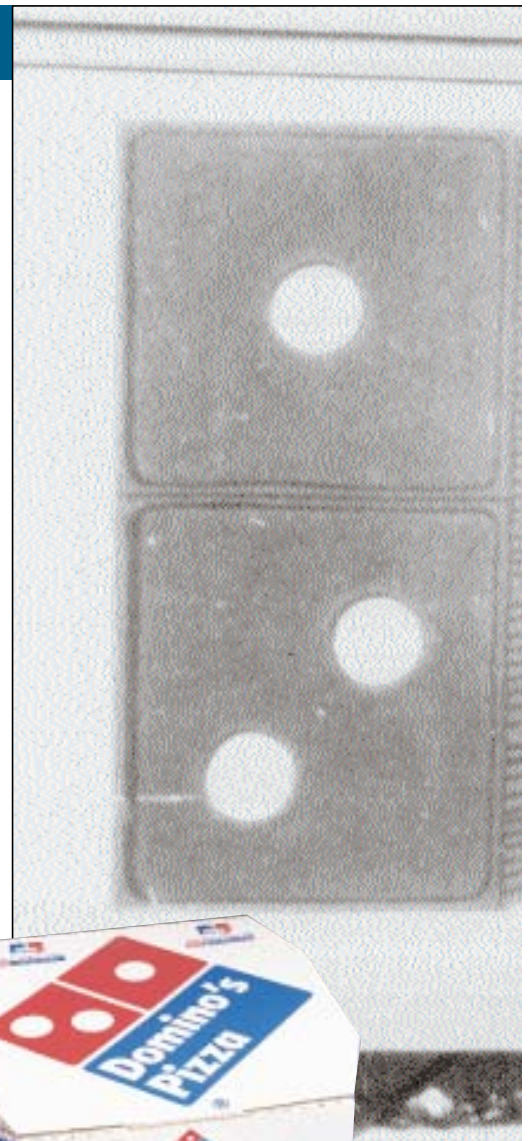


franchising - 85% of stores are owned by franchisees. Potential franchise holders are expected to have a sound knowledge of the local market and culture, access to funds, a commitment to a long-term relationship, a 'hands-on' management style and a good knowledge of and access to the local real estate market.

Nearly all Domino's Pizza franchise owners started out as store employees and Cathal McDonnell is no exception. He worked for the company between 1997 and 2000 and having returned from two years abroad to manage a couple of outlets in Dublin, he decided to pursue his own franchise.

"The idea of taking a franchise began to form when I came back to Ireland in 2002," he explained. "I went to see Dominos in the U.K. with the support of Kevin O'Driscoll, for whom I had managed stores in Dundrum and Rathmines. However, until I found a suitable property or the company came to me with a property we could not progress, so 18 months passed between the first contact and opening my first store in Carlow last October."

Cathal has a silent partner as well as Serge, whom he met when working in Dublin. "I trained managers for other Dominos stores in the past and Serge was a trainee manager at the time," Cathal recalled. "He later became Dominos World Rookie Manager of the Year and his stock was high in the company so we both had

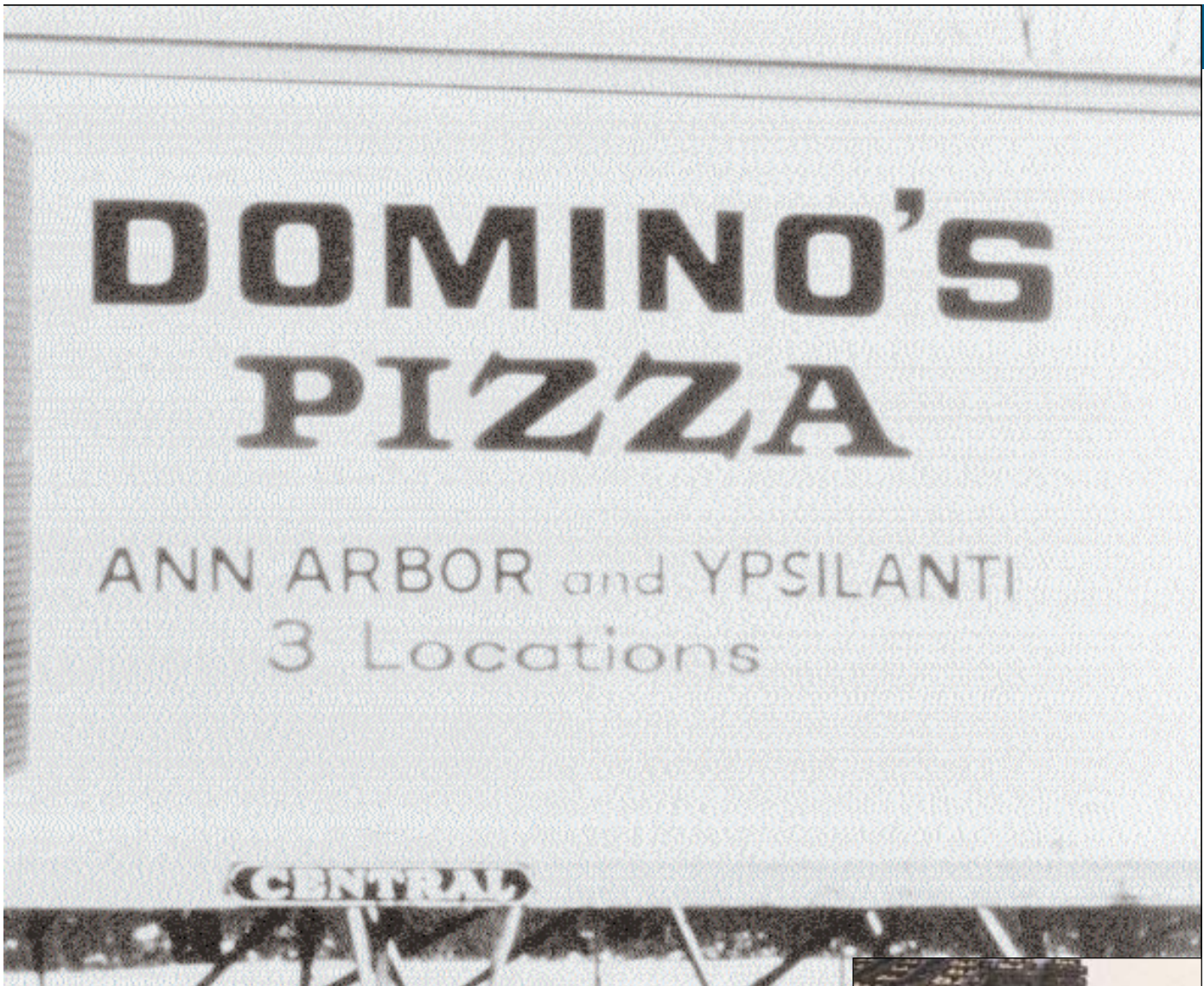


the right background."

When someone is accepted as a Dominos franchisee they enter a development programme, which involves a high degree of support. For the first six weeks the company offers (at the franchisee's expense) to put someone into the outlet full-time, but because Cathal and Serge already knew what was involved they didn't need that level of assistance.

When Carlow was identified as a possible location Cathal spent some time researching the area. "We knew there were differences between Dublin and Carlow, but we noted the amount of housing development going on and figured that the potential market would grow. There is also a large student population."

The Cork store presented a different challenge. It was acquired from a previous Dominos franchisee in March and was not



performing to its potential. “We took it over with the idea of building on its performance,” he said. “This has been a challenge but we had experience of how to do it from our time in Dublin. Retraining staff has been key to the process of impressing people who might have felt let down by the standard of service they received in the past.”

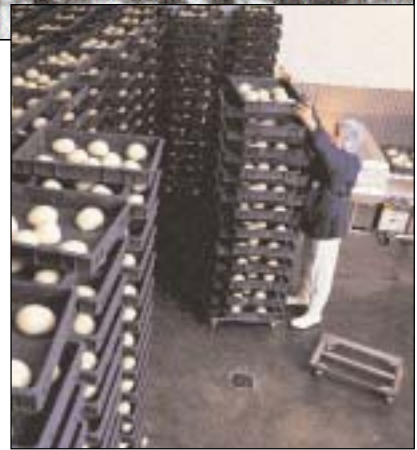
Training is a topic he comes back to frequently: “Staff development and customer service are a competitive advantage. We need staff who know their job and deliver a quality product. It also helps with staff retention if they see the company investing in them - there are always management opportunities and many franchisees have worked their way up from ground level.”

Most of the marketing activity involves direct promotions. Franchisees are free to do their own local advertising and corporate ad campaigns can be tweaked for specific markets. The business also conducts tours of community facilities in Carlow and sponsors sports teams,

charities and kids groups.

Cathal cannot speak highly enough of the support received from the master franchisor. “The Dominos marketing department is very pro-active. Deliveries are reliable - I cannot remember being let down even once - and we receive regular inspections to ensure we are meeting standards of service and hygiene. Dominos is very strict in relation to food safety and insists on using fresh produce.”

There are now more than 300 Dominos stores in Ireland and the U.K. and Cathal says the company is actively looking for new outlets. Catchment areas are restricted to maintain service levels. To borrow Cathal’s expression, they don’t want to slice the pie too thinly.



Full of Eastern Promise

The owners of the Asian restaurant chain Lemongrass came up with a great idea and now their business is thriving. Report by **Olive Keogh**

In May 2000 businessman Niall Browne invited three friends to join him for a game of golf at the K Club. His friends (all restaurateurs) had never met, but Browne knew they would hit it off.

He also had a hunch that this meeting of entrepreneurial minds might spark an idea for a new business. He was right. The rapidly expanding chain of Lemongrass Asian restaurants is the brainchild of this golfing get-together.

"We began to meet regularly to discuss ideas," says Browne who runs his own drinks packaging and distribution company. "With so much restaurant and hospitality experience between us it was inevitable that any new business ideas would be connected to food. We chose the Asian theme because we felt the ethnic restaurant market was under served, especially outside Dublin.

"Our aim was to produce good quality Asian food in the medium price range. A three course meal for two with wine costs around €75 at a Lemongrass restaurant."

Browne and his partners split the responsibilities for setting up the business between them. They also recruited Asian food expert, Oliver Mueller, to act as mentor to the venture. Mueller is now the company's full-time director of food and product development.

Browne's partners in Lemongrass are Brian Fallon, owner of The Red House Inn Country Hotel in Newbridge, Paul Mullen, former owner of Bernays Bar and Restaurant in Kilcullen and Joe Gray, a former partner in Jo Olives Restaurant in Naas.

Lemongrass opened its 92-seat flagship restaurant in Naas in May 2001. A second restaurant, a 130-seater outlet in Maynooth, was opened nine months later. The company's third outlet is based in the



Lemongrass, Naas

Citywest Hotel in Saggart. Lemongrass is not averse to high profile locations but Browne says they are unwilling to shoulder unnecessarily high overheads. "We don't see high street locations as essential and we feel provincial Ireland offers better opportunities than Dublin city," he says.

The Lemongrass theme is contemporary Asian with light furnishings and open-fronted kitchens, which allow customers to enjoy the spectacle of their food being prepared. A chain of Lemongrass restaurants with a commonality of food, design and layout was planned from the beginning. So too was a franchising element to the business.

"We could see that the business would lend itself to franchising," says Browne. "The failure rate for new restaurants is high with around 70% no longer in business after two years. The success rate for franchised restaurants is much better. Over 80% of franchises are still open after two years. The average profit margin in the restaurant business is 5%. We aim to give our franchisees a margin of 10% after they have paid our fee."

The Lemongrass operation is divided in two. One side of the group's business,

Lemongrass Restaurants, is comprised of its three self-owned restaurants. These employ 125 staff, had sales of €5.8m in 2003 and delivered profits of €450,000.

The other side of the business is the franchising arm and central production facility that come under the umbrella of Lemongrass Fine Foods. These operations employ some 30 people and had sales of €2m in 2003.

There are currently six franchised Lemongrass outlets nationwide, plus a seventh in Belfast. Between them they employ 210 people and their annualised sales (some have not been open for a full year yet) are currently running around €10.4m. Browne believes there is scope for 35 Lemongrass outlets throughout Ireland.

"We looked at different franchising models and took the best from each to design our own," he says. "A really good central kitchen is critical and we opened a 17,000sq ft state-of-the-art facility in Kilcullen several months ago. All the vegetables are prepared there as well as other essential items such as sauces and dressings. This ensures consistency of quality and taste."

So far, Lemongrass has been funded from



Lemongrass, Maynooth

the resources of the four partners who are equal shareholders in the business. Browne estimates that it has cost around €5.5m to bring the company to its current position. “Lemongrass is like a toddler but it’s finding its feet fast,” he says. “With the central kitchen operating well and our ‘openings team’ in place we should be able to open one Lemongrass outlet a month.”

Although Lemongrass is still a young company the partners have already been approached by some high profile potential investors. Browne sees this as a strong vote of confidence in how the business is developing. “We don’t take the view that equity is blood. We’re prepared to consider outside investment when the time is right,” he says.

With the Irish operation now up and running, plans are underway to open Lemongrass outlets overseas. “The UK, northern Europe and Marbella, where so many Irish people now have second homes, are all possibilities,” says Browne. “But we intend to grow in a sensible, structured way not at an egotistical rate.”

The company is also about to unveil its plans for a second themed restaurant chain. “These restaurants will be family friendly

with a ‘Med Fusion’ menu offering familiar dishes such as pasta and pizzas,” Browne says. “We believe there is scope for about 50 all over Ireland. As with Lemongrass, we will start with our own operation. This will allow us to sort out any teething troubles and to set the standards we expect our franchisees to follow.”

As Lemongrass restaurants become an increasingly familiar feature of the Irish provincial landscape Browne says there is a brisk level of enquiries from potential franchisees. “At this stage there is almost a profile of the typical candidate approaching us,” he says. “They are usually late 30s and making a career change. Many have backgrounds in IT and financial services.”

Browne says that a Lemongrass franchise should be profitable from year one. “We advise people that their food and labour costs should both be 30%,” he says.

The cost of becoming a Lemongrass franchisee is €35,000 up front plus the cost of renting and fitting out a premises, which Browne estimates at between €135 and €150 per sq ft depending on the location and type of building. Staff costs are additional. Franchisees pay Lemongrass an

annual fee of 8% of their net turnover. They also make a 1% contribution to the central marketing budget.

Currently the Lemongrass operation is still run by the four partners. However, Browne says that over the last six months three new management appointments have been made. “We have appointed a financial controller, a sales/marketing manager and a general restaurant manager so we are addressing the issue of our management structure,” he says.

“We have the strengths we need to run this business between us but we also recognise that if we are to focus on the growth and development of the company, we will need to appoint a CEO. Lemongrass has the potential to become a very large business. The structures we put in place now are critical to how strong we are going forward.”



This case study first appeared in *The Sunday Times* as part of its Enterprise Network series.