Chapter 4: Franchising

Franchising and the Entrepreneur

The Franchising Boom!!!
- Sales of $1.4 trillion annually from virtually every product or service imaginable
- Franchise sales account for 50% of total retail sales
- Top 500 U.S. franchisers operate more than 358,000 outlets with sales of $400 billion worldwide

Global Franchising
- 52% of U.S. franchisers have international outlets
- Of the U.S. franchisers who operate globally, 30% of their total outlets are located in other countries
- Hot markets: Europe and Pacific Rim
Franchising

- Franchising - semi-independent business owners pay fees and royalties to a parent company in exchange for the right to sell its products and services under the franchiser's trade name and often to use its business format and system.

![Franchising Diagram](image)

<table>
<thead>
<tr>
<th>Element</th>
<th>The Franchiser</th>
<th>The Franchisee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Site selection</td>
<td>Oversees and approves; may choose site</td>
<td>Chooses site with franchisor's approval</td>
</tr>
<tr>
<td>Design</td>
<td>Provides prototype design</td>
<td>Pays for and implements design</td>
</tr>
<tr>
<td>Employees</td>
<td>Makes general recommendations and training suggestions</td>
<td>Hires, manages, and fires employees</td>
</tr>
<tr>
<td>Products and services</td>
<td>Determines product or service line</td>
<td>Can only recommend prices</td>
</tr>
<tr>
<td>Prices</td>
<td>Can only recommend prices</td>
<td>Must meet quality standards; must purchase from approved suppliers if required</td>
</tr>
<tr>
<td>Purchasing</td>
<td>Establishes quality standards; list of approved suppliers if required</td>
<td>Ensures only with franchisor's approval</td>
</tr>
<tr>
<td>Advertising</td>
<td>Develops and coordinates national ad campaigns; may require franchisor's approval on local ads</td>
<td>Pays for national ad campaign; complies with local advertising requirements</td>
</tr>
<tr>
<td>Quality control</td>
<td>Sets quality standards; enforces them with inspections; trains franchisees</td>
<td>Maintains quality standards; trains employees to implement quality systems</td>
</tr>
<tr>
<td>Support</td>
<td>Provides support through an established business system</td>
<td>Operates business on a day-to-day basis with franchisor's support</td>
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Types of Franchising

- Tradename
- Product distribution
- Pure (Business format)
Why Buy a Franchise?

- Franchisees are buying the franchiser’s experience.
- “Going into business for yourself but not by yourself”
- Franchisees get a proven business system and avoid having to learn by trial-and-error.
- Before buying, ask: “What can a franchise do for me that I cannot do for myself?”

Benefits of Franchising

- Business system
- Management training and support
- Brand name appeal
  - “Cloning”
- Standardized quality of goods and services
- National advertising program

Benefits of Franchising

- Financial assistance
  - Franchise Registry
- Proven products and business formats
- Centralized buying power
- Site selection and territorial protection
- Greater chance for success
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Greater Chance for Success

- Study: After 5 years, 90% of franchises are still in business compared to 40% of independent businesses.
- The difference?
  - Services, assistance, and guidance that experienced franchisers offer their franchisees.

Success Rate Comparison


What Franchisers Want in Franchisees

1. People skills  94%
2. Ability to be coached  87%
3. General business skills  86%
4. Access to capital  84%
5. Entrepreneurial mindset  76%
6. Specific industry skills  29%
Drawbacks of Franchising

- Franchise fees and revenue sharing
  - Average franchise start-up cost is $200,000
  - Royalty: 1% to 12% of sales
- Strict adherence to standardized operations
- Restrictions on purchasing

Ten Myths of Franchising

1. Franchising is the safest way to go into business because franchises never fail
2. I’ll be able to open my franchise for less money than the franchiser estimates
3. The bigger the franchise organization, the more successful I’ll be
Ten Myths of Franchising

4. I’ll use 80 percent of the franchiser’s business system, but I’ll improve upon it by substituting my experience and know-how
5. All franchises are the same
6. I don’t have to be a “hands-on” manager. I can be an absentee owner and be very successful

Ten Myths of Franchising

7. Anyone can be a satisfied, successful franchise owner
8. Franchising is the cheapest way to get into business for yourself
9. The franchiser will solve my business problems for me; after all, that’s why I pay an on-going royalty
10. Once I open my franchise, I’ll be able to run things the way I want to

Franchising and the Law

- Key tool for protection is the Uniform Franchise Disclosure Document (UFDD)
- Franchisers must deliver a copy of UFDD before any offer or sale of a franchise
Franchising and the Law
- The UFDD contains information on 23 topics, including:
  - Franchiser’s business experience
  - Franchise fees and costs
  - Lawsuits involving the franchiser
  - Financial assistance available
  - Territorial protection granted
  - Restrictions on purchasing

Detecting Dishonest Franchisers
- Claims that the contract is “standard; no need to read it”
- Failure to provide a copy of the required disclosure documents
- Marginally successful prototype or no prototype
- Poorly prepared operations manual
- Unsolicited testimonial from “a highly successful franchisee”

(Continued)
- Unusual amount of litigation by franchisees
- Promises of future earnings with no documentation
- High franchisee turnover or termination rate
- Attempts to discourage your attorney from evaluating the contract before signing it
Detecting Dishonest Franchisers (Continued)

- No written documentation
- High pressure sale
- Claims to be exempt from federal disclosure laws
- "Get rich quick" schemes, promising huge profits with minimal effort
- Reluctance to provide a list of existing franchisees
- Evasive, vague answers to your questions

How to Buy a Franchise

Preparation, common sense, and patience are vital ingredients in choosing the right franchise

- Evaluate yourself - What do you like and dislike?
- Research the market
- Consider your franchise options
- Get a copy of the franchiser's Uniform Franchise Disclosure Document (UFDD) and study it

What Should You Look For?

- A unique concept or marketing approach
- Profitability
- A registered trademark
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What Should You Look For?

- A business system that works
- A solid training program
- Affordability
- A positive relationship with franchisees

How to Buy a Franchise

- Talk to existing franchisees
- Ask the franchiser some tough questions
- Make your choice

Table 4.4 Advantages and Disadvantages of Buying a New vs. an Established Franchise

<table>
<thead>
<tr>
<th>Pros</th>
<th>Cons</th>
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<td><strong>New Franchise</strong></td>
<td><strong>Established Franchise</strong></td>
</tr>
<tr>
<td>• Can be new and exciting&lt;br&gt;• Business concept can be fresh and different in the market&lt;br&gt;• Possibility of getting lower fees as a “pioneer” of the concept&lt;br&gt;• Potential for a high return on investment</td>
<td>• Business is not tested or established in the market&lt;br&gt;• Unknown brand and trademark&lt;br&gt;• Possibility that the concept is a fad with no staying power&lt;br&gt;• Franchiser may lack the experience to deliver valuable services to franchisees</td>
</tr>
<tr>
<td><strong>Pros</strong></td>
<td><strong>Cons</strong></td>
</tr>
<tr>
<td>• Business concept likely is well-known to consumers and market for the products or services is already established&lt;br&gt;• Franchiser has experience in delivering services to franchisees&lt;br&gt;• Franchiser has had time to work the “bugs” out of the business system</td>
<td>• High franchise fees and costs that often are non-negotiable&lt;br&gt;• Concept may be on the wane in the market&lt;br&gt;• Franchiser’s brand and trademark may remind customers of an outdated concept&lt;br&gt;• Franchiser’s “trade dress” may be in need of updating and redesigning</td>
</tr>
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Franchise Contracts

FTC Study: 40% of New Franchisees Sign Contracts Without Reading Them!!!

Note clauses covering:
- Termination
- Renewal
- Transfers and Buybacks

Trends Shaping Franchising

- International opportunities
  - Global markets offer fast-growth opportunities
  - Major markets: Canada, Mexico, Japan, Europe
  - Key to success: Adaptation
- Smaller, nontraditional locations
  - Intercept marketing

Trends Shaping Franchising

- Internet franchises
- Conversion franchising
  - 72% of North American franchisers use as a growth strategy
- Multiple-unit franchising
  - 34% of franchisees operate multiple outlets (and growing)
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Trends Shaping Franchising

- Master franchising
- Piggybacking (or combination or multi-branded franchising)
  - “Buddy system”
- Serving aging baby boomers

Franchising as a Growth Strategy

- Issues to consider:
  - Is your business model replicable?
  - Have you developed an expansion plan?
  - Have you performed the necessary due diligence?
  - Do you have proper legal guidance?
- Initial cost to launch a franchise business is $100,000 to $750,000

Franchising Web Sites

- Entrepreneur’s Franchises and Opportunities
  http://www.entrepreneur.com/franchiseopportunities/index.html
- Inc.’s Franchise Resource Center
  http://www.inc.com/resources/franchise/
- International Franchise Association
  http://www.franchise.org/
- FRANdata
  http://www.frandata.com/