

Important things you should know about Franchising

Expert knowledge means success



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Note: This publication has not been updated since it was last published. Some of the hyperlinks may have changed and may need updating. In addition, some of the information in this publication may be out of date.

Introduction

Franchising is an arrangement whereby an existing business agrees to allow another (usually a retailer) to sell its goods or use its name within a specific area. Put simply, an existing business, the franchisor, will grant a 'franchisee', or the third party retailer, the right to operate under the franchisor's trade name and use its proven method of doing business. In return, the franchisor will usually receive a fee from the franchisee, as well as a continuing income from it based on the fledgling business' turnover, the materials and services supplied to it by the franchisor, or some other method related to the size of the franchisee's business.

How did Franchising start?

Perhaps the first real modern-day franchising operation was that of McDonald's. Brothers Mac and Dick McDonald opened the first "Speedee Shakes and Burgers" drive-in called McDonald's in 1953 in San Bernadino, California.

The McDonald brothers were persuaded to sell the name to a milkshake salesman, Ray Kroc, who opened the first store of the McDonald's Corporation in 1955 in Des Plaines, Illinois. McDonald's now has over 20,000 outlets in 90 countries. The company claims it serves 29 million people a day and that a new store opens somewhere in the world every seven hours. Ray Kroc, who bought the business from the Macdonald brothers in the 1950s, identified the advantages of a business that could be replicated a hundred, a thousand and even ten thousand times. And we all know how many hamburgers have been sold since then - so the idea clearly worked!

Not surprisingly, this 'business concept' form of franchise has proved immensely popular, since not only does it provide an opportunity for others to take an existing business idea and run it along proven, successful lines, but also enables the owners of the original business concept to increase their income considerably, with very little risk.

Almost any business can be franchised. But with each, care must be taken to provide the Franchise with every opportunity to succeed, and that means careful planning.

From the franchisor's point of view, getting the right franchisees for his business is the key factor, as is the handling of the relationships between the two. Good communications are essential to ensure the relationship is a happy one, while there is no better advertisement for prospective franchisees than a number of well-established existing sites already operating successfully.



Important Questions

Anyone thinking of establishing a franchise should ask themselves several important questions first:

- Is there sufficient wide-scale market demand?
- Is the product or service competitive and able to be duplicated by others in a number of different locations?
- Does it have staying power, or is it just a passing fad?
- Can a distinctive image be created to attract customers (perhaps a simple and memorable name)?
- Can a simple manageable framework be established?
- Can effective controls be established?
- Is there sufficient depth of management in the business to recruit franchisees and lead and develop the franchise network?

The Franchise Agreement

The franchise agreement forms the basis on which the franchise will operate, and, if correctly prepared, will ensure a healthy relationship between franchisor and franchisee over the years. Franchise agreements vary considerably from franchise to franchise. It is important to get the franchise agreement right from the very start of the franchise operation, since early mistakes at this stage can prove disastrous later on. As a result, it's essential to take professional financial and legal advice in preparing the agreement and to structure it to suit your business needs.

How a Franchise Works in Practice

When you take on a franchise, you own and operate your outlet yourself, but the franchisor retains control over the way in which their products and services are marketed.

Franchising reduces the risks of self-employment. You benefit from a recognised brand name and proven goods and services. You also receive help and support from the franchisor company.

You will have to pay a fee to the franchisor company, in addition to running your business in strict compliance with the terms laid down by the franchise contract.

Checklist

Choosing the right franchise is key to your success. We publish a detailed franchising but here are the main things to consider:

Your Capabilities

Tick when completed

- Do you have the necessary personal commitment?
- Do you have the support of your family?
- Are you fit and healthy?
- Do you have the required skills and experience?
- Do you know what it takes to run your own business?

The Franchise Cost

Tick when completed

- What does the initial franchise fee cover?
- Does it include an "opening" stock of products and supplies?
- How much of the initial cost can be met from your own resources? How much will you need to borrow to cover start-up and working capital costs? Do you own anything that could be offered to the Bank as security? For example, your property, Life Policy, Guarantees etc.
- What are the payment terms to the franchisor - amount, time of payment, lump sum or instalment, financing arrangements, etc.?

- Does the franchisor offer any financing, or offer help in sourcing financing?
- Are there any deferred balances? If so, who finances it and at what rate of interest?
- Is any part of the initial fee refundable?
- Does the contract clearly distinguish between "total cost", "initial fee", "initial cash required", and/or "initial costs" etc.?
- Are there periodic royalties? If so, how much are they and how are they calculated and payable?
- How and when are sales and royalties reported, and how are royalties paid?
- If royalty payments are in whole or part payment for services by the franchisor, what services will be provided?
- Are accounting/bookkeeping services included or available?
- How are advertising and promotion costs shared?
- Is a specified amount of working capital required of the franchisee to cover operating costs until profits can be made?
- Must premises be purchased or rented, and are there further conditions on either of these (from franchisor, selected site, etc.)?
- How and by whom will the building be financed, if purchased?
- Does the franchisee have to make a down payment for construction and/or equipment?
- Is the cash flow and profit forecast provided by the franchisor feasible - what level of income will be required to support the outlet and repay borrowing?
- Do the franchisor's figures allow for taxation, depreciation etc?
- Does projected income cover not only commitments but also an acceptable standard of living?
- If sales/profit projections are not met, could you borrow more or use your own resources?
- Are goods supplied at cost or at a marked-up price as part of your fees?
- Have you discussed your Business Plan with a franchise specialist accountant?

The Franchise Contract



Tick when completed

- Obtain a copy of the franchise contract and have it assessed by an accountant experienced in these matters (and also ask a specialist solicitor to review the terms).
- What is the length of the contract and your right to renew it?
- Is there a renewal charge?
- Does the contract guarantee exclusive territory to each franchisee?
- Does it confirm the franchisor's provision of training and support?
- Does it impose restrictions on things such as equipment and suppliers?
- Does it state whether the business can be sold? Under what terms and conditions can this happen?
- Are minimum performance requirements included and what are the consequences of failure to meet them?
- In what circumstances can the contract be terminated?
- Does the contract state who's responsible for providing advertising and promotional support?
- What would happen in the event of your death?

Further Information

This guide is for general interest - it is always essential to take advice on specific issues. We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

We also publish a detailed Franchise Checklist publication - so, if you think you have a good business idea which could be franchised or want to buy a franchise, please call us – see our contact details on the next page. Also, if you wish, you can obtain further information on franchising from these organisations:

The British Franchise Association www.thebfa.org/

International Franchise Association www.franchise.org/

The American Franchise Association www.franchisee.org/

Irish Franchise Association www.irishfranchiseassociation.com

Franchise Council of Australia www.franchise.org.au/

Franchisees Association of Australia <http://faai.org.au/>

Franchise Association of New Zealand www.franchiseassociation.org.nz/

Canadian Franchise Association www.cfa.ca/

The Franchising Association of South Africa www.fasa.co.za/

Franchising Association of India www.fai.co.in/

World Franchise Council (Franchising organisations around the World) www.worldfranchisecouncil.org/control/productfc

European Franchise Association <http://www.eff-franchise.com/>

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