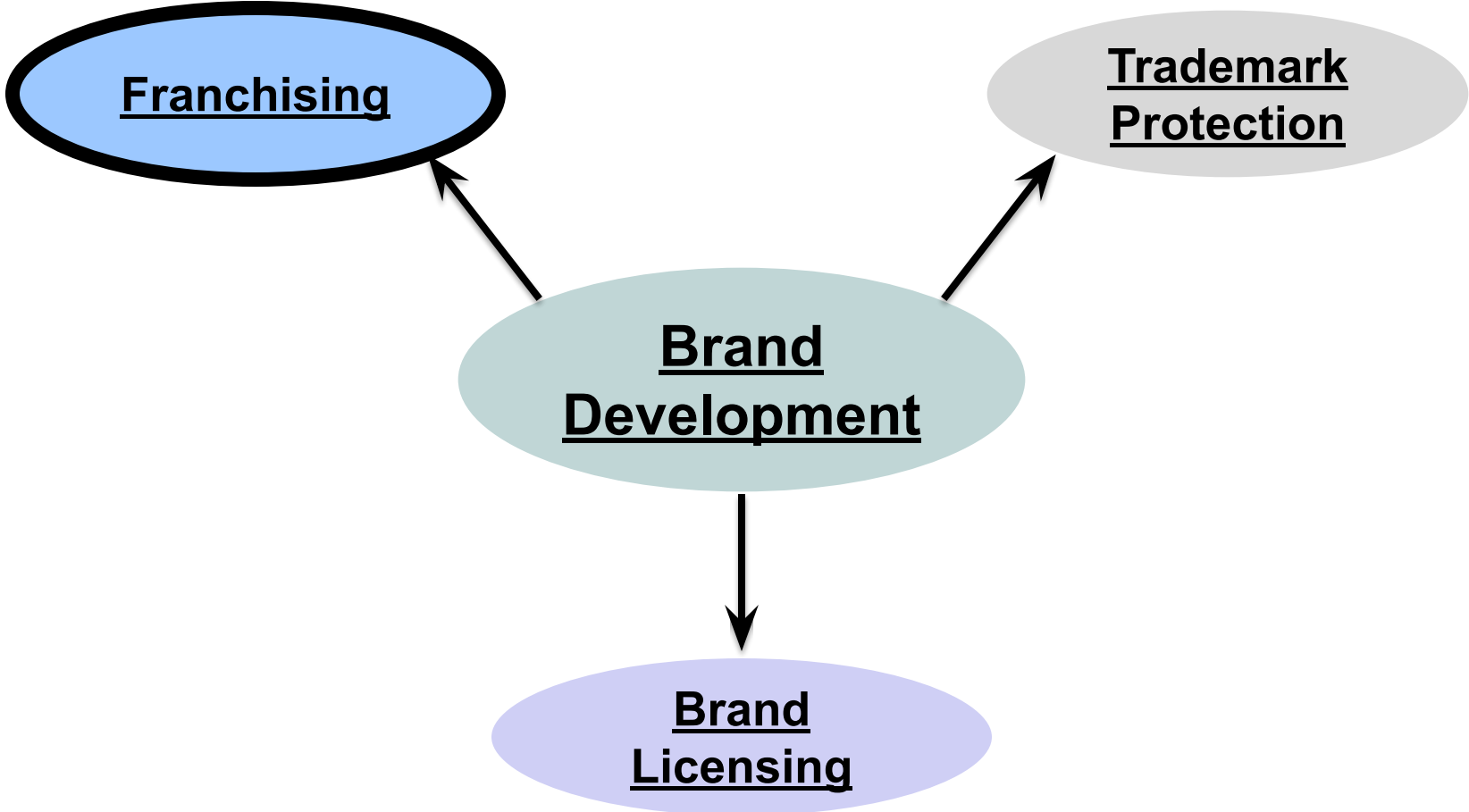


# Franchising

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# Definition

- **Franchising** is the practice of paying to use another firm's successful business model
- For the **franchisor** ( seller), the franchise is an alternative to building 'chain stores' to distribute goods and avoids the need for investments and liability for a chain.
- The buyer has a greater incentive than a direct employee because he or she has a direct stake in the business.
- For the **franchisee** (buyer), the franchise is a way to profit from a proven business idea and to reduce the risk of investment in an unknown idea or brand

# How Franchising Works

- Think of franchising as paying someone for his or her business strategy, marketing strategy, operations strategy, and the use of his or her name.
- That's pretty much what franchising is -- you are establishing a relationship with a successful business so you can use its systems and capitalize on its existing brand awareness in order to get a quicker return on your own investment.
- You are using its proven system and name, and running it by *its* rules.



# Advantages of Franchising

- The biggest advantage of franchising for the franchisee is the **reduction of risk** taken for the investment.
- This is because franchises typically get up and running faster, and are profitable more quickly.
- This is as a result of better management as well as a well-known name.
  - According to the Small Business Administration (SBA), most small businesses fail because of weak management.
- When you lease a franchise, you are leasing that **managerial know-how**.
- You also usually get better deals on supplies because the franchise company can purchase goods and supplies in bulk for the entire chain, and then pass that savings on to you and the other franchise units.
- The often-**instant recognition** from customers is also a big plus.

# Advantages of Franchising (cont.)

- Think about it: If you are in a town you've never visited before and have the choice of a Sergei's Pizza or Chelantano's Pizza which one are you more likely to chose?
- Until you know that Sergei's is THE place for pizza, you may not want to take the chance.
- For the customer, the advantages of a franchise include the comfort of knowing what you're getting - the quality of the product or service at one location will be comparable to that of another location.
- The questions for you as a potential franchisee are:
  - Are you looking for something that is uniquely yours?
  - Or do you simply want to run the show, regardless if it's by someone else's rules?

# Characteristics of a Good Franchise

- A good track record of profitability
- Ease of duplication
- Detailed systems, processes and procedures
- A unique or unusual concept
- Broad geographic appeal
- Relative ease of operation
- Relatively inexpensive operation.

# The Cost of Franchising

- There are two groups involved in a franchise, the **franchisor** (the person or company leasing the rights to the business name and system) and the **franchisee** (the person who purchases it).
- The right to the franchise is sold by the franchisor to the franchisee for an initial sum of money, often called the up-front entry fee, or **franchise fee**. This money will be paid once the contract has been signed. The contract (**franchise agreement**) details the responsibilities of both the franchisor and the franchisee, and is usually for a specific length of time (typically several years).
- This initial franchise fee doesn't include anything except the rights to use the name and system, and sometimes training, procedures, manuals, and other assistance like site selection. It doesn't include any of the necessary inventory, fixtures, furniture or real estate.





# The Cost of Franchising (cont.)

- In addition to the franchise fee, the franchisee must pay the franchisor **royalty fees**, or other on-going payments. These payments are usually taken as a percentage of sales, but can also be set up as a fixed amount or on a sliding scale. The terms of these fees will be spelled out in the franchise agreement. These payments are for the on-going services and support that the franchisor provides. Franchisors may also sell supplies directly to their franchisees.
- **Advertising funds** are also paid periodically. These funds are usually put into a general account and used for national and regional promotion for the entire chain.



# Franchising Agreement Details

- Two important payments are made to a franchisor: (a) a royalty for the trademark and (b) reimbursement for the training and advisory services
- A fee for "disclosure" is separate and is always a "front-end fee".
  - One franchisee may manage several such locations.
  - Agreements typically last from five to thirty years, with premature cancellations or terminations of most contracts bearing serious consequences for franchisees.
  - A franchise is merely a temporary business investment involving renting or leasing an opportunity, not the purchase of a business for the purpose of ownership.
  - A franchise can be exclusive, non-exclusive or 'sole and exclusive' for a specific geography.

# Restrictions

- The success of most franchises is based on the operating systems, methods, and products produced.
- A business's trade secrets are often vital to its success.
- In order to protect the trade secrets, they establish restrictive covenants for their franchisees, which govern the things a franchisee can do
- For example, one restrictive covenant may state that the franchisee cannot operate another similar business that would compete with the franchised business during the term of the franchise agreement.
- These are called **in-term non-competition covenants**.
- There may also be **post-term** non-competition covenants that prohibit the franchisee from operating a similar business even after the terms of the franchise have expired.
- It is an understood rule that franchisees will keep trade secrets strictly confidential.



# Ten Largest Franchises

- **Hampton Hotels**
  - Mid-priced hotels
  - \$3.75M - 13.11M
- **Subway**
  - Submarine sandwiches & salads
  - \$84.8K - 258.8K
- **7-Eleven Inc.**
  - Convenience store
  - \$30.8K - 611.1K
- **Servpro**
  - Insurance/disaster restoration & cleaning
  - \$132.05K - 180.45K
- **Days Inn**
  - Hotels
  - \$202.17K - 6.76M
- **McDonald's**
  - Hamburgers, chicken, salads
  - \$1.07M - 1.89M
- **Denny's Inc.**
  - Full-service family restaurant
  - \$1.13M - 2.4M
- **H & R Block**
  - Tax preparation & electronic filing
  - \$35.51K - 136.2K
- **Pizza Hut Inc.**
  - Pizza, pasta, wings
    - \$295K - 2.15M
- **Dunkin' Donuts**
  - Coffee, doughnuts, baked goods
  - \$368.9K - 1.74M

# Top 20 Franchises to Start

<u>Franchise</u>	<u>Business</u>	<u>Fee</u>	<u>Royalty</u>
Jackson-Hewitt	Tax Service	\$25,000	15%
AmeriSpec	Home Inspection	\$25,000	7%
Coffee News	Publication	\$4,000	5%
Merry-Maids	Home Cleaning Service	\$25,000	6%
Stretch -n- Grow	Youth Fitness (Mobile)	\$10,000	\$100/month
Christmas Décor	Decorating Service	\$13,000	3%
U.S. Lawns	Com'cl. Landscape Svc.	\$29,000	4%
Vanguard Cl'ng. Svc.	Com'cl Cleaning Svc.	\$12,000	5%
CruiseOne	Travel Agency	\$10,000	3%
RescueCom	Computer Repair	\$17,000	18%
Jazzercise	Dance and Fitness Instr.	\$1,000	20%
Heaven's Best	Carpet & Up'lstry Cl'ng.	\$14,000	\$80/month
Home Instead	Seniors Comp'on Svc.	\$25,000	5%
ProForma	Marketing Materials	\$19,000	7%
Criterion	Eng'nr. Cons't. Svcs.	\$26,000	6%
Roto-Rooter	Plumbing and Drain Svc.	\$10,000	Varies
Bonus Bldg. Care	Commercial Cleaning Svc.	\$7,000	10%
7-Eleven	Retailer	\$31,000	GPM
Amer Pool Ply'rs Assn.	Billiards Halls	\$2,900	20%
Kumon Tutoring	Home Math Tutoring	\$1,000	\$35/stdnt/mo.

