
Background Information

The term 'franchising' has been used to describe many different forms of business relationships, including licensing, distributor and agency arrangements. The more popular use of the term has arisen from the development of what is called 'business format franchising.'

Business format franchising is the granting of a license by one person (the franchisor) to another (the franchisee), which entitles the franchisee to trade under the trade mark/trade name of the franchisor and to make use of an entire package, comprising all the elements necessary to establish a previously untrained person in the business and to run it with continual assistance on a predetermined basis.

The principle is simple - some companies choose to grow, not by developing in the conventional way, but by granting a license to others to sell their product or service. There are clear advantages to this:

- You don't have to come up with a new idea - someone else has had it and tested it, too!
- Larger, well-established franchise operations will often have national advertising campaigns and a solid trading name
- Good franchisors ([BFA members](#)) will offer comprehensive training programmes in sales and indeed all business skills.
- Good franchisors can also help secure funding for your investment as well as e.g. discounted bulk-buy supplies for outlets when you are in operation
- If aware that you are running a franchise, customers will also understand that you will be offering the best possible value for money and service - although you run your 'own show', you are part of a much larger organisation.

Who is in Control?

Each business outlet is owned and operated by the franchisee. However, the franchisor retains control over the way in which products and services are marketed and sold, and controls the quality and standards of the business.

What are the Cost Implications?

The franchisor will receive an initial fee from the franchisee, payable at the outset, together with on-going management service fees - usually based on a percentage of annual turnover or mark-ups on supplies. In return, the franchisor has an obligation to support the franchise network, notably with training, product development, advertising, promotional activities and with a specialist range of management services.

Introduction

The 1998 Natwest/BFA Franchise Survey reveals that franchising - currently a £7 billion industry in the UK - continues to expand in terms of franchise systems, units and sector turnover of employment.

UK franchisors and franchisees are optimistic for the future, both for their own business and for the economy in general. 95% of franchisors say that expectations for their business will improve in the next 12 months (up from 84% year on year) the highest figure yet recorded. A total of 568 franchise systems have been identified - an annual increase of 5%.

The franchisor selects the franchisees and retains control over his products and services. Since franchisees invest their own money and work for their own profit they are likely to be highly motivated to succeed. Centralised costs and overheads are usually lower for a franchise network than for a network of company-owned outlets - few skilled staff can manage the entire network from a single central office.

Is Your Business Franchisable?

All sorts of businesses in all sorts of markets now use the franchise method successfully; but not all businesses are franchisable. If your business has one or more of the following characteristics, franchising may not be suitable:

- A product or service which is only likely to have a market for a short time (e.g., toy hoola hoops)
- Gross margins which are too low to offer a return on investment to both you as the franchisor, and your franchisees (e.g. newspaper delivery)
- Skill levels for each operating unit that require very long training periods (e.g., management consultancy)
- Predominantly repeat business customers whose loyalty relates to the individual providing the service and which would be difficult to transfer to a brand (e.g. marriage counselling)
- A geographically defined market that doesn't have the potential to be repeated in many places (e.g. Tower of London)
- A business with audit and control requirements which are too critical to involve franchisees operating as separate legal entities (e.g., a bank)
- A business, which is failing.

If you think your business might be franchisable then you will need to offer franchisees a business format which includes your brand, business system, and support services under the contractual terms of a franchise agreement which will, amongst many other things, set out the financial arrangement.

Considerable development work is required before you will be in a position to draw up offer documents and begin recruiting franchisees.

Each of these topics is covered on the following sections.

Franchising Your Business: The Brand

As a Franchisor you will be building a brand with a reputation that other people will want to buy into.

You will therefore need a brand, which is distinctive and appropriate for all the places you would want to have franchisees in operation.

It will also be your responsibility, and your obligation to franchisees paying for the benefit of using your brand, to protect it against abuse, both by outsiders and by ex-franchisees. You will therefore need specialised advice on protecting your trade and service marks. The British Franchise Association maintains a listing of lawyers with the necessary experience.

Franchising Your Business: The System

The principal benefit, which Franchisors hold out to prospective franchisees, is the opportunity to run a business, which has already proved its capacity to deliver products or services profitably to an identified market.

You cannot sell an idea as a franchise. You must have proven in practice that the idea works and that you can successfully transfer the "know how" to another person operating at "arms length" from you.

You will need to draw up and prove a comprehensive operations manual that details what a franchisee does, how they are to do it, and to what performance and quality standards. The manual(s) will need to cover the setting up phase as well as continuing operation.

You will also need to develop and prove an initial and continuing training programme that ensures that the "know how" contained in the operations manual(s) can be transferred successfully to a third party within the time available.

The work involved in proving and documenting your operating and training systems is extensive and ordinarily calls for highly skilled and experienced advice.

The British Franchise Association would be happy to offer some introductory guidance. The Association offers a manual for prospective franchisors and maintains a listing of the UK consultants qualified to help.

Franchising Your Business: The Support Service

One of the biggest practical differences between a simple distribution scheme and a fully-fledged business format franchise is the extent of the initial and continuing support services offered by franchisors to franchisees.

Franchisors take on responsibility for product and service development, for national promotion and PR, for purchasing financial and administrative services, for quality control and national accounts, for network communications and discipline.

The skills involved are not the same as those required by field managers in company owned networks and there is an investment involved in making sure the necessary support services can be delivered to your first franchisee as well as your fiftieth.

The extent of support offered varies according to the kind of business that the franchise is in and according to how it is structured. A job franchise network (where e.g., the franchisees do the drain cleaning) will offer extensive administrative and financial services to its franchisees.

A management franchise (where the franchisees employ and manage) will not be so much involved in day-to-day administration but will be providing training to franchisees on (e.g.) recruiting and selecting staff amongst many other services related to supporting management functions.

You will also need to make sure that your franchised business is structured so that your franchisees need your services on a continuing basis and in consequence will want to go on paying you to belong to the network.

Again, professional advice at the outset could save you a great deal of money and trouble in the long run.

Franchising Your Business: The Agreement

Franchise agreements must be fair and comprehensive. They are not sales brochures and there is not one standard work that fits any business.

These days, a good agreement will stretch to forty or more pages and is just as much concerned to set out the obligations of you the franchisor as well as your rights. It is equally concerned to set out the rights of the franchisee as well as their obligations.

That does not mean that franchise agreements are an equal balance of rights and obligation between equal business partners. Franchisors are responsible for the network as a whole and that sometimes means acting against the interests of an individual franchisee for the greater good of the network.

Franchise agreements have gone through more than twenty years of development to ensure that franchisors have the appropriate rights to do their job within a framework of fair and reasonable treatment for franchisees.

There are only a limited number of UK lawyers familiar with the complexity of franchise agreements, and only some of those have the necessary skills to advise a business on the best way to structure a franchise agreement.

In this area you must get fully experienced professional advice. [Sources](#) are available from the British Franchise Association.

Franchising Your Business: The Financial Arrangements

You're in business to make money and there's no point choosing a growth strategy, which doesn't maximise your profit potential. Some franchisors would be more profitable if they owned their own outlets themselves. On the other hand they would never have grown to a fifty or two hundred unit chain without franchising.

As with any business planning process the financials have two different approaches:

- What will it cost me, so how much must I charge to make a sensible return?
- What price will the market bear, so what can I afford to spend to make the business profitable?

In franchising you have to address these questions both from your point of view as the franchisor, and from the point of view of your franchisees.

In constructing a viable financial plan for franchising a business don't:

- Underestimate your initial costs and the associated financial prospects;
- Overestimate the early growth rates when you're just learning how to attract the right prospects;
- Assume you can make any real profit element on the initial fees. Profit comes later from the on-going charges to franchisees based on their trading success.

In Europe the approach is to keep initial fees to franchisees as low as possible to maximise their chances of a successful business entry, and then to make sure that franchisees can see a value for money return on the continuing fees they pay.

Continuing fees calculated as a percentage on turnover are preferable but some product distribution franchises inevitably rely on a mark up on goods supplied.

The financial aspects of franchised businesses are just as much a specialist area as the legal. The British Franchise Association can steer you in the right direction.

Franchising Your Business: The Offer Documents

If you are selling the opportunity to use your brand and your business system, with the benefit of the support systems you offer, within the framework of a franchise agreement and initial and continuing fees, you will need a "prospectus".

Potential franchisees will want to know what business they can expect to do and how profitable it can be.

Since your business is already up and running, and since you will have already run a pilot scheme discrete from your own operation, you will have some facts on which to base your projections.

Good franchisors have to draw a fine balance between generating expectations, which can be met, and giving franchisees targets which are so low that they do not need to fully exploit their business opportunities.

You shouldn't oversell or undersell, but that's also a matter of matching the presentation of your offer to the norms of the franchises' recruitment market, so experienced advice can be helpful. The British Franchise Association is a good source.

Franchising Your Business: Recruiting Franchisees

Recruiting franchisees is probably the hardest and most expensive job for franchisors. New franchisors have conversion ratios of serious enquiries to appointment of around 10:1. Established franchisors have a conversion ratio which is often higher than 50:1 sometimes higher than 100:1.

The recruitment mechanisms open to you are:

Franchise exhibitions

Be careful to avoid those where association with bad franchised businesses could spoil your reputation.

Newspaper Advertising

Some national newspapers have developed an active franchise market.

Trade Magazines

There are three franchise magazines two of which are available through newsagents. Their support can be important.

Referrals

Existing franchisees have friends, colleagues and customers. If they are happy with their business they will encourage others.

British Franchise Association

The BFA sells more than 3,000 information packs each year to prospective franchisees. The pack operates a "selector pack" for franchisor members to promote their opportunities.

Franchise Centres and Brokers

Beware of any arrangement, which places a financial incentive on a third party to recruit franchisees for you. You will be in danger of taking on the wrong people. Ensure that the selection process and the relationship is directly between you and each prospective franchisee.

Specialist advice on profiling the best candidate for your business can be very helpful. The British Franchise Association can help you find the right advisors - there is a [list of BFA affiliated advisors](#) on The British Franchise Association web site at www.bfa.co.uk

Becoming a Franchisor

There are several steps, which potential franchisors should take:

- Seek expert advice from the British Franchise Association (BFA). The BFA Franchisor Guides is invaluable in providing a wealth of unbiased step-by-step information for potential franchisors.
- The BFA can provide introductions to consultants, solicitors and accountants experienced in franchising and accredited by the BFA to meet BFA ethical franchising standards and help you identify whether or not your business is suitable to franchise.

- Research the market to ensure that products and services are competitive and distinctive enough to be franchised and that customer demand is sufficiently widespread.
- Produce a Business Plan outlining proposals in full and including a detailed SWOT analysis.
- Protect all intellectual property rights by registering trademarks, trade names and patents with the relevant trademark and patent offices.
- Test the franchise in the form of a pilot operation lasting at least 12 months - ideally longer if the business is in any way seasonal. The pilot scheme should be undertaken at more than one location in order to test the concept in different geographical areas. A comprehensive pilot operation will prove the viability of strategy and approach, highlight problem areas, and enable the franchisor to fine-tune the package before committing fully to developing a network.
- With the pilot operation running successfully, the franchisor can prepare and launch his network. At this stage the franchisor should instruct a solicitor familiar with franchising operations to draw up a comprehensive franchise contract setting out the obligations of each party - including how the fees, mark-ups on supplies and any other payments from the franchisee are to be calculated. These obligations should be made clear at the outset of any agreement with a franchisee, to prevent possible conflicts in the future.
- Produce a prospectus to attract suitable franchisees, and to determine the criteria for the franchisee selection.
- Produce a comprehensive operations manual and training programme for franchisees. This will enable the franchisor to set and maintain standards of customer service throughout the network.
- Establish a central management function and possibly field support staff to support the franchise network, and set up a system to monitor the performance of franchisees.
- Finally, develop marketing, sales and advertising strategy to promote the franchise network, especially when competing with rival companies that potential customers are fully aware of the services on offer.

The franchisor will need to commit substantial amounts of time and money before their income stream begins - for market research studies, pilot schemes, promotional material explaining the benefits of the franchise to potential franchisees, the selection and training of franchisees, the production of an operations manual, the formation of a central management team, initial stock and equipment, the launch of the franchise network and advertising.

Once the network is up and running, the franchisor and the central management team need to constantly monitor the performance of the outlets, to ensure that quality levels are maintained and to identify and assist any franchisees that are in difficulties. A franchisor's on-going commitment, through training, product development and other support, is vital to the success of the franchise network.