The Franchise Alternative

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ANY new business involves risk. The proportion of new businesses that fail within their first two years of operation is much higher than those that succeed. Whether you can afford the risk of your business failing depends on your own individual circumstances. If you are continuing in full-time paid employment and your business is something you start in your spare time for a little extra cash to see how it goes before quitting your job, then you are more likely to be able to afford the risk of that business ultimately not succeeding.

But what if you've lost your job, taken a package, and are looking for a business in which to invest the proceeds of your package? All of a sudden the risk of your new business failing looms very large indeed.

One way of reducing that risk is to consider buying a franchised business.

WHAT IS A FRANCHISE?

Simply put, franchising involves the owner of the business which is being franchised ("the franchisor") granting to the person who wants to offer the products and services of the franchisor ("the franchisee") rights to use its trademarks, business names, associated intellectual property, know-how, business systems, training systems and operating manuals in exchange for monetary payment in the form of an initial franchise fee/purchase price and/or ongoing royalty payments which are typically calculated as a percentage of the franchisee's turnover.

ADVANTAGES OF A FRANCHISE

- Proven system

The franchisor has already done the work of establishing a system for the business being offered for franchise. This system provides you, the franchisee, with a roadmap to follow, hopefully to success. The franchisor has already tested and refined all aspects of the business and has created a "business success formula" for the franchisee to follow. This means that you are spared the trial and error of working out what works and what doesn't and are therefore freed to focus on "working the system", hopefully generating profits within a short period of time.

- Avoid many start-up problems

Starting a business from the ground up requires a lot of time and effort just getting the basics in place. These include major undertakings such as developing a reputation in the market place, obtaining finance to fund the new venture and overcoming competitive threats, as well as the more mundane such as what business licenses to obtain and what insurance cover to purchase. The franchisor will have already done a lot of this work. For example, the franchisor will already have developed a reputation for the business in the market place, will have identified competitive threats and opportunities, incorporating ways of meeting them within the franchise system and will usually have already established relationships with service providers such as financiers.

- Existing name and reputation

As stated above, you do not need to invest significant time and effort into getting your business known in the marketplace as the franchisor will already have done this for the benefit of the group as a whole.

- Support when needed

You are not on your own when things go wrong. Got a business problem? Contact your franchisor for assistance. The franchisor will have employed many different specialists within its organization who are there just to assist franchisees successfully operate their businesses. In my 14 years of experience in franchising, the most successful franchisees were those who were not afraid to ask for help when needed. The most unsuccessful were those who thought they knew it all or, for whatever reason, refused to ask for help when they needed it.

- Group buying power

Depending on the size of the franchise network, the group should benefit from being able to negotiate favorable buying prices because of their ability to generate volume sales for the supplier.

- Group advertising

By contributing advertising fees into a group fund, individual franchisees are able to benefit from much greater advertising exposure than they could afford if each franchisee had to market their business on an individual basis.

- Greater knowledge base

The franchisor is likely to have invested in market research for the benefit of the group as a whole. This means the group has a much greater knowledge of their market(s) than does the local "independent" competitor. The results of this market research can be put to good use in the group's advertising and marketing programs.

DISADVANTAGES OF A FRANCHISE

- Restrictions on autonomy

Because you're buying the rights to participate in a proven "system", the franchisor will be concerned that all franchisees adhere to the system and not operate outside it. After all, if franchisees are free to adhere to the system or not as they see fit, there is no point in buying into a franchise at all. For this reason, for the benefit of the system as a whole, franchisors will generally impose strict controls on things such as the quality and types of products and services that you may offer for sale, the types of local advertising you may undertake, methods of dealing with customers, ethical conduct and the like.

Although I've categorized this factor as a "negative", it can equally be viewed as a positive. As a franchisee, you want to know that your franchisor is not going to allow its franchisees to damage the reputation of the system in which you've invested your hard-earned dollars.

- Pay initial franchise fee and purchase price

There may be an initial investment ranging from a few hundred to tens of thousands of dollars to buy into a franchise.

- Pay ongoing royalties

In addition to the initial franchise fee and purchase price, most franchisors will also charge an ongoing royalty for the rights to use the franchised system. These royalties are usually calculated as a percentage of turnover but various other fee structures exist.

- Restrictions on ability to sell business

Some franchise agreements can restrict quite severely your rights to sell your business to another franchisee. They may impose strict criteria for proposed purchasers and you may find it difficult to find buyers who meet this criteria.

- May not be able to realize value for business on termination

Some franchise agreements state that upon the expiration or termination of the franchise agreement, the goodwill of the business reverts to the franchisor. This means you may have operated and developed a business over many years and yet, when the franchise agreement expires, you effectively walk away from the business with no further financial compensation.

Under this type of arrangement you must understand going in that you are expected to derive your financial return during the term of the franchise agreement by way of annual profits, not by way of a capital gain at the end of the franchise term.

WHAT TO LOOK FOR IN A FRANCHISE

- An established franchise system with a good reputation.

- Comprehensive training systems for both your own management team and other employees.

- A relatively harmonious relationship between franchisor and franchisees. Some friction from time to time is inevitable in any long-term business relationship but a constant atmosphere of hostility, mistrust and long-running disputes can be a warning sign of an unstable system.

On the other hand, if you're looking at a franchise system of any significant size, a completely harmonious relationship between franchisor and franchisee can be a signal that the management of the franchisor is weak. Although a weak management team on the franchisor side may translate into short-term personal benefits for franchisees, in the long-term it undermines the stability and foundation of the franchise system itself and, ultimately, the value of your investment.

- Ethical business practices both by franchisor and existing franchisees.

- An inclusive "partnership" approach on the part of both franchisor and franchisees. This does not mean that the franchisor should not impose controls on the system but you should look for a spirit of goodwill and cooperation, willingness to listen to others' ideas and a climate of open communication at all levels throughout the organization.

- Exclusive territories - although not crucial, exclusivity of territory (where the franchisor grants you a limited but exclusive territory which is yours alone) can in some cases be a relevant factor to the competitiveness of the business. It would be fair to say that it does not benefit the franchise system if franchisees are forced to compete with each other for limited business.

These are just a few of the major factors you should take into consideration when deciding whether a franchise is for you. Although franchising minimizes the risks of business failure, it cannot not eliminate them entirely and any decision to proceed with a franchised business should only be made after a thorough reading of the franchise agreement and accompanying disclosure documentation and obtaining the professional advice of both your lawyer and your accountant.

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