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FRANCHISE BASICS

Is Buying a Franchise Right for You?

MY FRANCHISE PARTNERS

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Is Buying a Franchise Right For You?

We will present the information you need to help make that decision.

Buying an existing business doesn't appeal to you.

Starting from scratch seems to be beyond your skills and knowledge.

Then you may be an ideal candidate for owning a franchise.

What is a franchise and how will you know if it is right for you?

The person who buys the franchise is the franchisee. The company that operates and manages the franchises is the franchisor. It is their name that you see on the sign.

A franchisee pays an one time franchise fee when they sign the franchise agreement. Franchisees also pay ongoing royalties to the franchisor. Royalties may be a flat monthly fee but they are usually paid monthly as a percentage of sales.

In return for the franchise fee and royalties, the franchisee has access to the trademark, training and ongoing support from the franchisor as well as the right to use the franchisor's operating system for doing business and sell its products or services.

In addition to a well-known brand name, a franchise agreement includes many other advantages that are not available to independent business owners.

The most significant advantage for a franchisee is the proven operating system and the training they receive to use that system effectively. Franchisees avoid the mistakes common to an independent start-up. Through years of trial and error the franchisor has already perfected daily operations and marketing ideas.

The most reputable franchisors conduct market research before selling a new location, so you'll feel confident there is demand for the product or service at the target location. Failing to invest in adequate market research is one of the biggest mistakes made by many entrepreneurs. Instead of ready – aim – fire too many small business owners adapt an approach of ready – fire – aim.

As a franchisee, the market research is done for you, it is part of the franchise deal. The franchisor arms you with a clear picture of the competitive landscape and how to gain marketplace differentiation.

Finally, franchisees enjoy the unquestionable benefit of strength in numbers. You will benefit from economies of scale in buying materials, supplies, services and advertising. Franchisors also use their leverage to find better locations and negotiate the most favourable lease terms.

Because independent business owners negotiate deals on their own, they usually get less favorable terms. Some suppliers reject their business because their account is too small.

Franchise or Business Opportunity?

Business opportunities are less structured than franchises. As such, defining a business opportunity isn't as easy to pin down.

A business opportunity is essentially any package of goods or services that enables the purchaser to begin a business and in which the seller represents that it will provide a marketing or sales plan, that a market exists for the product or service and that the venture will be profitable.

Other key factors:

- A business opportunity doesn't generally feature the seller's trademark; buyers operate under their own name
- Business opportunities are usually less expensive than franchises
- They usually don't charge ongoing royalties
- Buyers operate without geographic or operating restrictions
- Some business opportunities offer less on-going support

Franchising - The Pros

The greatest strength of a franchise system is its ability to bring together independent retailers using a single trademark and business concept.

The benefits of a franchise affiliation are many:

- brand awareness
- uniformity in meeting customer expectations
- the power of pooled advertising
- the efficiencies of group purchasing

There are several advantages to franchising. The ever-present risk of business failure is reduced when the business program has already proved to be successful in the marketplace; the use of an established trademark saves the business owner the cost of creating and advertising a name that customers will recognize; and the advantages of group advertising and purchasing make operations more profitable.

In addition, ongoing training creates instant operational expertise that would otherwise need to be acquired through years of trial and error. Expansion seems to come more naturally with franchises.

Operating a successful franchise may quickly lead to growth with a second and then a third location and so on. Many fortunes have been built this way.

The Benefits

• Reduced risk

• Turnkey operations

• Standardized products and systems

• Standardized financial and accounting systems

• Collective buying power

• Supervision and consulting readily available

• National and local advertising programs

• Point-of-sale advertising

• Uniform packaging

• Ongoing research and development

• Financial assistance

• Site selection guidance

• Operations manual provided

• Sales and marketing assistance

The Cons

Franchising is not for everyone nor is everyone right for a franchise. Fiercely independent entrepreneurial types (you know the type) may chafe under the strict operational requirements and specifications of a franchised business.

If things must be done your way, or you think you are smarter than everyone else, you may want to go in a different direction. As should be expected, some franchise systems are better than others and some simply suit different people better than others.

Good franchise programs train you to handle the challenges of the business, do a good job of assisting you when problems arise and will help you make the best use of your advertising dollars. Weak franchises are incapable of doing any of these key activities.

The Downside

• Loss of control

• A binding contract

• The franchisor's problems may become your problems

If you're considering buying a franchise, don't let glossy, unproven expectations influence your decision. Don’t buy the sizzle without verifying the steak is real.

Franchises are designed to put people into business who may have never owned a business before, have minimal experience in a chosen industry or those who want to build a business empire without starting from scratch. With the unsophisticated buyer, the excitement of ownership can create an impulse to move forward without proper planning and due diligence.

Rushing headlong into buying a franchise, expecting to increase your current working salary, may lead to short term disappointment. You need tom understand the ramp-up time, cash flow and ROI.

It is a good idea to work with an experienced CPA to prepare a cash-flow projection for the business before taking the plunge. You need to understand how long it will take to break even and turn a profit, as well as the amount of salary you could realistically expect to pay yourself.

The front-end franchise fee is a one-time charge that a franchisor charges for the privilege of using the business concept, attending their training program, and learning the entire business. There will also be an ongoing royalty fee, typically ranging from 2% to 10% of monthly sales, or a flat monthly fee.

Some of the other costs associated with a franchise include:

Facility/Location

In some instances, you may need to lease or possibly even buy land or a building

If you rent a building, you will be responsible for not only the monthly lease but for the one-time security deposit as well. In addition, you will have to pay for leasehold improvements. The leasehold improvements or build out costs tend to make up the largest portion of the initial investment.

In some cases, the landlord or building owner will absorb the leasehold improvement costs as inducement to rent the space. In other situations, the landlord may factor these costs into your rent, possibly charging an additional fee.

The franchisor might provide you with an allowance for leasehold improvements that could reach $10,000 to $100,000. Most franchisors can tell you the range of expectations for leasehold improvements.

Equipment

A variety of businesses need various pieces of equipment.

There are generally long-term payments available for equipment purchases or lease agreements. Private finance companies and equipment suppliers offer lease programs.

Signage

Outside signage can be expensive for a small-busines. Bricks and mortar type franchisors have usually developed a sign package that the franchisee is obligated to purchase.

Opening Inventory

This will usually consist of at least a two to four week supply. Most franchisors will tell you what their opening inventory requirements are.

On-Going Inventory

Try to understand the frequency of inventory turns per year. Mitigating factors include the price of the goods you will be selling. Your CPA can help with this. This will help you decide on the ideal inventory level.

Working Capital

You may be required to deposit the first and last months' rent payments plus a security fee. You will likely also need to pay a deposit for electric, gas and telephone services. They will expect a deposit prior to providing their service.

You will need some working capital and money in the cash drawer to make change, cover short term payroll needs and meet the needs of regular bills.

Advertising Fees

There is usually an ad fund fee for advertising on a regional or national basis. Most larger franchisors require their franchisees to pay a certain amount into a national advertising fund used to advance the market awareness of the concept. This fund can only be used for marketing the brand at the macro level. However, you can adapt much of this collateral for your local needs.

Franchise Law

An important protection for the person investing in a franchise is the FTC's Franchise Rule, put into effect October 21, 1979. The rule requires covered franchisors to supply full disclosure of the information a prospective franchisee needs to make a rational investment decision.

This disclosure must take place at the first personal contact where the subject of buying a franchise is discussed and at least 10 business days prior to signing any contract with the franchisee or before the franchisor accepts any money as payment for the franchise.

This "cooling-off' period is intended to prevent franchisees from jumping in without carefully reviewing and considering what they're doing. This allows time to seek independent expert advice.

This means a franchisor, franchise broker or anyone else representing franchises for sale has to present a disclosure document-the Franchise Disclosure Document (FDD)-containing extensive information about the franchisor. The FDD almost always comes from the franchisor.

Furthermore, you must be provided with completed contracts covering all material points at least five days prior to the actual date of executing the documents, this is the Franchise Agreement. This provides a second cooling-off period and the chance to have an attorney review the contracts prior to signing.

The FTC does not require franchisors or business opportunity sellers to register with it or any other government agency. However, several states have individual registration rules requiring franchise sellers to register.

Some of these state laws are tougher than others, but most have adopted the FDD guidelines for their disclosure requirements. It would be a mistake to assume that simply because a franchise is registered with a state, or provides some type of full disclosure document, you as a consumer are going to be protected from the possibility of failure.

There is a possibility of failure in all business endeavours. Franchisors cannot guarantee your success, you need to follow the system, seek advice when necessary and work hard.

The only thing a state reviewing agency can do is ensure that the franchisor has responded and filed the necessary documents.

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