

Franchising: An Overview

What is franchising?

So you're considering a franchise? Great! Franchising presents a great opportunity to own your own business?with a little bit of help to keep you on the right track.

Franchises make up about 3.2 percent of all businesses in the US, and about 35 percent of all retail and service revenue. In fact, there are over 2,500 franchise systems in the United States with over 600,000 units. Why are so Americans investing in franchises? There are many reasons.

In practical terms, buying a franchise is basically buying a "branch" of a preexisting business that you then operate in accordance with a corporate contact. The corporation predetermines major decisions. It's basically like buying an instruction manual on how to operate a successful business. You'll get a business strategy, a marketing plan, a system on which to base your operations?and you'll even get instant brand recognition with the use of a corporate name. You'll also receive corporate support, so you won't have to go it completely alone.

However, by establishing a relationship with a preexisting corporation, you agree to use its system and to operate by its rules. Technically speaking, you won't actually own your business?you'll own the assets you've purchased in order to run the business.

So how does it work?

Franchising is an agreement between a franchisor?that actually owns the company and leases out the rights, and the franchisee, the person buying those rights and opening an individual branch location. Initially, the franchisee will sign a contract, or a franchise agreement. This details the obligations of both parties, and designates a period of time for which the contract is valid. The contract will also lay out terms for fees. The franchisee will then pay the franchise fee, which covers the up-front costs. This includes only the rights to use the company's name and system. Occasionally, it will include training, manuals, and other assistance. However, the franchisee is responsible for getting real estate, inventory, and other assets necessary to actually open the business. The franchisee is also responsible for paying royalty fees, which are on-going payments for support and services provided by the franchiser. These fees usually reflect a percentage of sales, or some other previously agreed-upon amount.

And finally, franchisees will pay advertising fees periodically. These fees go into the general fund for national and regional advertising costs.

At the time that both parties agree upon the contract, there will also be restrictive covenants put into place. This is a way in which a franchiser protects him or herself?so that trade secrets, recipes, or management systems can't be comprised. Standard covenants include non-compete clauses, which prohibits a franchisee from running a similar business while under the terms of their contract. This clause is sometimes extended for a period after the contract has expired to prevent the franchisee from immediately opening their own business based on the secrets they learned while franchising.

Additionally, there are federal and state laws that apply to franchise agreement to protect trade secrets?necessary for the success of both franchisors and franchisees. The Uniform Trade Secrets Act has been adopted by most states for this reason.

What are the benefits?

The biggest benefit of opening a franchise is that it presents lower risk than opening up your own business from scratch. Not only do franchises tend to open more quickly, but they also begin earning profits sooner. Of course, this makes sense for several reasons. Firstly, if you're opening a popular franchise, you have a built in customer base. If you decide to open a Starbucks in your neighborhood, all you have to do is hang the sign?people are already aware of the goods and services that are available, and many of them already purchase your product. Customers know what they're going to get. Secondly, because you're working from a management plan that has proven success, you won't have to go through the growing pains and management adjustments faced by many new businesses.

Other benefits may include special rates on supplies and services, since they may be ordered in bulk with other franchise locations.

What are the drawbacks?

Nothing is perfect?including franchising. While there are a lot of benefits, there are also limitations. Yes, you are your own boss, but you won't have as much independence as if you simply opened your own business. You must follow the system designated by your franchise, and there's little flexibility within that. Furthermore, there's limited growth potential. The ultimate goal of a franchiser is to open more franchises, so they may grant another license in your area that cuts in to your business profits simply to further the growth of the overall company. And finally, if for some reason the brand identity begins to suffer?at a local or national level?your business will be impacted, and the effects will be outside of your control.

Only you can decide if the benefits outweigh the risks of franchising?but it's important to be aware of all sides of the equation before leaping into any investment opportunity.

So how do you find the right franchise?

Before you even consider buying your own business, you should ask yourself hard questions about your motivation, your financial realities, and your plans for the future. But once you're actually ready to start looking, there are some rules of thumb and time-tested tips that can make the process easier.

First and foremost, you should choose a business you are interested in. Even when you're the boss, work is work. And preferably, choose something you're excited about. Similarly, you'll want to work with a product you understand. This may seem like a no-brainer, but more than one franchise has failed because the owner didn't have an accurate understanding of what they were trying to sell. Choose a franchise for a product you're familiar with, or perhaps already use yourself. It will lend a certain level of comfort in your business, and it will provide you with an insight into who your customers are?and how you can reach them.

Next, analyze your market. Check out the economy in your area, and evaluate industry trends. Check out the competition. Can your franchise generate enough business to survive? Is the product still hot? Do some research to make sure you're making a sound investment.

Once you've picked a product in an industry with potential in your area, you'll have to start looking for actual companies. When you find a few, you must do your homework. Check out the company in which you're interested. Research how many franchises are sold per year and how many of those are successful. Find out how long you'll need to own the franchise before you're allowed to sell, and any other terms or conditions. Also check out the market trends in your

area for the franchise in which you're interested.

You will want to visit the franchisors at their corporate location and meet with your field representative. In fact, make sure you meet everyone who's involved with the management of your franchise. The person trying to sell you the franchise will be very skilled at his job, and may bolster your confidence. But make sure to get a "second opinion." Talk to other people in the company and verify everything you've been told before you sign an agreement. You'll also want to get to know the district supervisor you'll be working with. Find out how long they've been in their position, and try to assess their strengths. This is the person you'll probably have the most contact with after you open your franchise, so establish a positive working relationship now and it will be beneficial later.

Then, make the rounds and visit a variety of franchises in your area. You'll probably be given tours of several locations, so feel free to call owners back at a later date to get their take on the franchise. Find out how long they've been in business, discuss any issues they've had with the parent company, and find out if they had a positive purchase experience. Also ask if they've discovered any tips to succeed they'd be willing to share.

And don't forget to talk to the failures. While the reasons why your fellow franchisors failed might not seem relevant, you can absolutely learn from their mistakes. Try to find original owners to hear their sides of the story, and see if you can establish a pattern of what went wrong.

What comes next?

Once you find a franchise you'd like to invest in, you'll contact the corporation, and they'll send you materials, including a questionnaire. Based on the information provided there, the franchiser will decide if they'd like to proceed, and will send you the company's Uniform Franchise Offering Circular. This is a comprehensive document you're required to receive by the FTC before you purchase a franchise. It includes the history of the franchise, financial information, including bankruptcy, a detailed documentation of fees and obligations of both parties, restrictions, trademarks, copyrights, lists of outlets, earning claims, and other applicable and important information. Review it thoroughly and discuss it with your attorney. Make sure you have a complete understanding of what you'll receive from the franchiser, what your obligations are, and what you should expect. Ultimately, your final decision to purchase this franchise will hinge upon this information.

The finishing touches

After you've reviewed all the materials and discussed the contract with your lawyer, both you and the franchiser will sign the franchise agreement, and you'll pay all the necessary fees. While you're well on your way, it can take several months after the agreement has been signed before your business is actually up and running.

At this point, you will take part in the franchisee-training program. This is a mandatory part of your agreement, and before you can open your doors, you'll have to meet the requirements outlined. If a franchiser is dissatisfied or feels you're unprepared to succeed, they may require you to complete additional training. You'll also have to acquire the assets necessary to operate your franchise, beginning with a lease. From here, you'll need to get the necessary merchandise or equipment and hire employees. Once all of these details are finalized, you will be prepared to launch your business—and open your doors!