What is the purpose of franchising?

Franchising is a method of marketing goods. It is important that this basic fact is understood; franchising is not an industry – indeed the use of franchising as a marketing method crosses industry borders. The application of franchising principles to each separate industry involves the blending of the ingredients to produce the right and product.

Having grasped that basic fact, it should be appreciated that as franchising is a marketing method it should be approached in a flexible way. Franchising in its full sense – the business format franchise – may not be a suitable method for your business. However, you may well find that certain elements can have application and provide benefits. If that is so adopt them, even if the end result is that you have not adopted a franchise for your business. In the final analysis you have to make and live with your decisions – if franchising is not right for you, or you are not right for franchising, do not embark on that course for it could well end in disaster. But, you should not lead franchisees into disaster – for that they do not need a franchisor: many of them could manage quite well on their own.

Other methods of marketing which are well known involve all levels from manufacture to retail sale. Some manufacturers or wholesalers appoint agents – those who will act on their behalf with power to undertake binding commitments. Others appoint distributors with whom they have a buyer/seller relationship. The distributor is an independent operator who may sell many competing ranges. Some manufacturers enter into licence agreements with others who manufacture their products or who carry out processes resulting in the production of goods. These arrangements may also involve trade mark licences coupled with know-how agreements under which the licensee manufactures or completes the manufacture of goods for sale.

None of these agreements is the sort of marketing method with which this manual is specifically concerned although, at times, business people refer to them as ‘ franchises’. The expression ‘ franchise’ is also used to describe the right given for the operation of commercial TV and radio networks. The operation of a motor car manufacturers’ dealership is usually called a ‘ franchise’ and in many cases quite rightly so.

The suggestion fell on open minds who really understood that it was possible to expand a network using the financial and manpower resources of others. However, the franchisor had to develop an infrastructure to enable it to cope. That infrastructure, the way in which it is put together and sustained, is what this manual is concerned to explain.

FACTS TO SUPPORT – ADVANTAGES

For franchisors:

Expansion

Franchising is one of the only means available to access venture investment capital without the need to give up control of the operation of the chain in the process. After the brand is carefully designed and properly executed, franchisors are able to sell franchises and expand rapidly across countries using the resources of their franchisees, earn profits commensurate with their contribution to those societies while greatly minimixing the risk and expense that would be inherent in conventional chain operations.

Legal considerations

The franchisor is relieved to obtain the necessary licenses and permits to start a new outlets. In some jurisdictions, certain permits are more easily obtained by locally based, owner-operator type applicants while companies based outside the jurisdiction find it difficult if not impossible to get such licences issued to them directly. For this reason, hotel and restaurant chains that sell alcohol often have no viable option but to franchise if they wish to expand to another state. Additionally, the franchisor is relieved of the obligation to carry liability insurance on the independently owned franchise units that produce the gross sales of the franchised system since this is the obligation and responsibility of the franchisees under the franchise agreement. As long as the franchisor's operational manuals is followed by the franchisees, the franchisors are generally always protected from any liability for any incident that occurs on the property of the franchisee. Franchisors can sell franchises without making any representations.

Operational considerations

Franchisees are said to have a greater incentive than direct employees to operate their businesses because they have a direct stake in the start up of the branded business and the tangible assets that wear the brand name. The need of franchisors to closely scrutinize the day to day operations of franchisees is greatly decreased. Franchisors can increase their profits on the gross sales of the franchisees and avoid the operational expenses for the physical units that wear their brand names. Franchisors can decrease their risk and therefore increase their profits as their franchisees bear the expense of operating the units and the expense of being employers.

For franchisees:

Employment

Opening a franchise is a way of personal business.

Quick start

As practiced in retailing, franchising offers franchisees the advantage of starting up a new business faster based on a proven trademark and formula of doing business, as opposed to having to build a new business and brand from scratch. A well run franchise would offer from site selection to lease negotiation, training and ongoing support and statutory requirements and troubleshooting.

Training

Franchisors usually offer franchisees significant training, which is not available for free to individuals starting their own business. Although training is not always free for franchisees, it is sometimes supported through the traditional franchise fee that the franchisor collects and tailored to the business that is being started. When training fees and travel expenses, etc.. are required beyond the initial franchise fee, these fees are deductible as part of the startup expenses of the business.

FACTS TO OBJECT – DISADVANTAGES

For franchisors:

Limited pool of viable franchisees

In any city, there may be only a limited pool of prospects who have both the desire to purchase and start up a franchised business, as compared to the pool of individuals who can be hired and trained to competently manage directly-owned businesses, as paid employees. However, in periods of recession where traditional good jobs are in short supply, this disadvantage disappears because those who can't find good jobs are willing to invest money in a franchise as a means of self-employment.

Control

Successful franchising necessitates a much more careful vetting process when evaluating the limited number of potential franchisees than would be required in the hiring of direct employees who may have experience in the concept sector. An incompetent manager of a directly-owned outlet can easily be replaced, while, regardless of the local laws and agreements in place, removing an incompetent franchisee who owns the tangible assets of the business is much more difficult.

For franchisees:

No guarantee

There is no guarantee of financial success for the franchisee made by the franchisor in the written disclosure circular and the actual franchise agreement. While the estimated startup costs of the franchise are an implied " earnings claim" some franchised outlets do fail. Unfortunately, the unit financial performance statistics are not required to be disclosed to new buyers of franchises and this omission makes it impossible for new buyers of franchises to assess the odds of success and failure of their investment in the franchise in terms of profitability and failure as experienced on a unit basis of the franchise system.

Control

For franchisees, the disadvantage of franchising is a loss of control. While they gain the use of a system, assistance, training, marketing, the franchisee is required to follow the system and get approval for changes from the franchisor. For these reasons, franchisees and entrepreneurs are very different. A franchisee “ is merely a temporary business investment where he may be one of several investors during the lifetime of the franchise. In other words, he is “ renting” the opportunity, not “ buying a business for the purpose of true ownership.” Additionally, “ A franchise purchase consists of both intrinsic value and time value. A franchise is a wasting asset due to the finite term: the franchisor is only obliged to renew the franchise if it chooses to contract for that obligation.”

Price

Starting a franchise business carries expenses. In choosing to adopt the standards set by the franchisor, the franchisee often has no further choice as to signage, uniforms etc. The franchisee may not be allowed to source less expensive alternatives. Added to that is the franchise fee and ongoing royalties and advertising contributions. The contract may also bind the franchisee to such alterations as demanded by the franchisor from time to time.

Conflicts

The franchisor/franchisee relationship can easily cause conflict if either side is acting in bad faith. An incompetent franchisor can damage its franchisees by failing to promote the brand properly or by squeezing them too aggressively for profits. Franchise agreements is unilateral contracts wherein the contract terms generally are advantageous to the franchisor when there is conflict in the relationship.

Summary:

Yes, franchising is the best business plan. Why?

Franchising your business can be a very successful way of expanding. Some of today's largest businesses have used franchising to finance and accelerate their growth into world brands – McDonalds, Kentucky Fried Chicken, Pizza Hut, Burger King, Body Glove and the Body Shop.

However, franchising must be planned step by step: –

It must be pilot tested with company owned and operated outlets.

Business must be successful, distinctive & replicable.

Take proper professional advice – Solicitor, Banker, Accountant and possibly Franchise Consultant.

Take time to write an operations manual.

Choose franchisees very carefully and wisely.

Avoid overselling and forecasts.

Focus on franchisee satisfaction and profitability.

Have first class training.

Maintain good ongoing relationships.

Keep developing the Franchise’s status and maintain standards.

Ensure marketing, advertising and PR are first class.

In commercial practice there are some elements which considers fundamental in full business format franchising. These are:

The provision to the franchisee by the franchisor of initial training in the operations of the franchised business – this is perhaps stating the obvious for the franchisee would not be able to carry on the franchised business without such training.

The fact that a franchisee will own their business; the franchisee is the owner of the business although they are obliged to run it in accordance with the franchisor’s system and under the umbrella of the franchisor’s name.

The franchisee will have to make a capital investment in their business. This is very important. The franchisee must have their own resources at risk. The investment they make must be sufficiently significant in relation to the franchisee’s total resources for the person to be worried that they might lose it. Conversely they will find motivation in their ability to increase the value of their investment in addition to producing a profit annually. A well-motivated franchisee with their own resources at stake will invariably conduct the business far better than any manager would, to the mutual advantage of themselves and the franchisor.

The advantages of franchising for a franchisor may be summarised as:

The growth of the network is achieved using the financial and manpower resources of the franchisee;

The franchisor is not concerned with the day to day operation of each outlet;

The franchisor’s organization is compact and can earn profits without involvement of high capital risk;

The network has an ability to grow rapidly;

The franchisor has less staff and it’s problems;

The management of each outlet is the owner who will tend to be well motivated to be successful;

It provides wider outlets for products and services;

It enables the franchisor to service national customers using their network of outlets.

Franchising is an exciting marketing method; when it is properly structured and well run it provides benefits and satisfaction for both parties. It is not an easy route to riches for franchisor or franchisee nor is it a panacea for the ills of a ‘ sick’ business. The establishment of a franchise has to be under-take with skill, patience and capital. The time scale for establishing a franchise system and preparing it for marketing can be as long as two years and it can take another three to six years before the franchisor begins to see net profits and cash flow. The capital requirements of the franchisor have to reflect these time spans.

For an example of Franchise Opportunity:

RIDPEST is a key player in the pest control industry in Malaysia and the first of its kind to embark on the franchise route. The driving force behind the growth and recognition of the RIDPEST brand is a strong set of corporate values that translates into continued growth for the future.

Franchising is undoubtedly one of the fastest-growing sectors of the Malaysian economy. Smart new business owners prefer a franchise, because it helps lower the risks of starting out, and offers savings on things like marketing and purchasing product.

Over the years RIDPEST had developed and refined its system to the point where we believe it gives its franchisees the very best chance to build a successful business.

CONCLUSION:

A proper business plan ensure the long run and success of a business whereas a business which lacks of proper plans and motivation cannot survive in the market and the tough competition the business world have to offer.

There are many ways a business plan is introduce and implemented in a trade. However, to have a proper business plan it is necessary that the business plan is on proper format and is not made casually or hastil.

ATTACHMENTS:

Application forms

Franchise loan

List of franchisor

Panel franchisor

Perbadanan Nasional Berhad (PNS) application checklist

Sample franchisor letter

Graph or chart

References of sources

References of sources:

The franchisor’s Manual – Martin Mendelsohn

Masters of Franchising – Mark Henricks

www. myfranchise. com. my

Business For Sale Magazine

www. mfa. gov. my