

Thinking About Franchising Your Business?

Once you have run your business successfully for a period of time, you may be considering expansion and starting a franchise is one such option. While it is possible to replicate the success of a business model with some types of business, there are some fundamental considerations to make before embarking on this type of expansion. When it first came into existence franchising was broadly frowned upon but in recent years the industry has enjoyed rapid growth.

A business can be replicated elsewhere on an exclusive territorial or geographic basis. This can provide the franchisor with substantial benefits such as the opportunity to grow rapidly, increasing the availability of finance, and being able to benefit from the motivation and energy of franchisees (who are generally more driven to succeed than employees, given that they have had to buy into the business.)

How A Franchise Works

A franchise allows other businesses, operated by franchisees, to use its company name, brand, and other intellectual property. The franchisor retains control on a continuing basis over the franchisee's business, and helps them to establish the business, and then to grow and succeed. The level of support and assistance depends on the type of business but may include training, IT support and other guidance. In return for the use of the business's intellectual property, and the ongoing assistance provided, the franchisee pays the franchisor a fee.

Franchises vary enormously – from wheelie bin cleaning franchises, to multi-million pound hotel and leisure complexes. To help you determine whether your business might be a suitable candidate for franchising, here are some issues to consider:

Finance

In order for your franchise to succeed, it is vital that you can show that your business model is a successful one and that franchisees are likely to be able to make a profit if they follow your system. Similarly, the vast majority of franchisees will borrow money to buy into your franchise, so it is important to have a good relationship with a bank that is willing to lend to your intended franchisees. New franchisors in particular must ensure that they address this issue, as a franchise can fail immediately if no banks are willing to lend to franchisees.

To give yourself, and your future franchisees, the best possible chance of being able to secure finance you must be able to demonstrate a number of elements to a prospective lender:

- Will the franchised business succeed elsewhere? You must be able to demonstrate that there is demand in other areas for the products and services that the franchise offers. If your business is regional or relies heavily on specific local suppliers, you will have to take this into consideration.
- Are you equipped to deal with the significant increase in workload that creating a franchised business will entail?
- How do you decide whether someone is likely to make a good franchisee and how stringent are your selection procedures?
- What are the IT systems in place to track and assist franchisees?
- What are the profit margins for franchisees like? (A typical split is 70% franchisee, 30% franchisor)
- What is your ongoing training like?
- How much are the initial franchise fees and what do they cover?

- Do you have the patience to deal with your franchisees? You want them to succeed, but do you have time to ensure that they do?

Feasibility

Once you have decided that your business is capable of being franchised – nearly all are, except for creative industries, highly technical businesses and those that operate with very low margins – the next step is to conduct a feasibility study. There are numerous franchise consultants operating in the marketplace but it is wise to approach this type of service with caution. If you do choose to employ the services of a consultant for this purpose, ensure that your consultant has sufficient experience in franchising to be able to assist you properly.

A Pilot Franchise

It is also worth operating a pilot franchise for at least a year. Not only does this give you time to develop materials for the franchise, such as the operating manual and training programme, it will also enable you to address any issues that arise while keeping the franchise operational on a manageable level. This does not necessarily mean recruiting a pilot franchisee, although a lot of franchisors do. Running a successful franchise is not like running a team of employees: you need to develop a new skill set for helping your franchisees to succeed.

The Risks

Although there are significant benefits to expansion, it is also important to consider the potential risks. One bad franchisee can cause significant damage to your brand and reputation. Establishing a franchise costs money and you will have to spend some of your profit on running the franchise, so your original company's profits may go down. In terms of running the franchise you will have to provide details of company secrets, know how, and methods of business that you certainly do not want your competitors to see. If a franchisee breaches this confidence, it can be difficult to detect and/or penalise.

Subsidiary company

In order to protect your original business it is worth separating it from your franchise business. Often franchisors create a subsidiary company that is the franchisor (a subsidiary is a company that is at least 50% owned by the parent company). That way, if the franchise fails, the main company can continue to operate without liability, unless it is the guarantor of the franchise business.

The Franchise Agreement

The most important document in any franchise business is the franchise agreement. This is a bespoke contract that sets out all the rights and obligations relating to the agreement between the franchisor and franchisee, and can make the difference between the success or otherwise of your new franchise. For advice from a specialist about franchising your business, contact us today.

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