

Franchising 101

Franchise Business Journal *Your Entrepreneurial Resource*

This presentation is intended solely to inform and educate entrepreneurs about franchising - the process, benefits, drawbacks and available resources.

Only the individual entrepreneur can determine if franchising is right for him.

What is Franchising?

Franchising is a method of distributing goods or services to consumers. The franchise system owns the right to the trademark of the business. The franchisee purchases the right to use the trademark and operating system.

Most people associate the word “franchise” with fast food restaurants. But, there are many more types of franchise businesses, including everything from advertising to automobile repair, printing services to party supplies and many more.

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Categories of Franchises

- ◆ Accounting/Tax Services
 - ◆ Advertising/Direct Mail
 - ◆ Auto & Truck Rentals
 - ◆ Automotive Products/Services
 - ◆ Batteries-Retail & Comm.
 - ◆ Beverages: Special
 - ◆ Business Brokers
 - ◆ Business/Mgmt Consultants
 - ◆ Campgrounds
 - ◆ Check Cashing/Financial Services
 - ◆ Children's Services
 - ◆ Clothing and Shoes
 - ◆ Computer/Electronics/Internet
 - ◆ Construction Materials
 - ◆ Consumer Buying Services
 - ◆ Convenience Stores
 - ◆ Cosmetics
 - ◆ Dating Services
 - ◆ Drug Stores
 - ◆ Educational Products/Services
 - ◆ Employment Services
 - ◆ Fitness
 - ◆ Florist Shops
 - ◆ Food/Restaurants
 - ◆ Golf Products/Services
 - ◆ Greeting Cards
 - ◆ Hair Salons & Services
 - ◆ Health Aids & Services
 - ◆ Home Furnishings
 - ◆ Home Inspection
 - ◆ Hotels and Motels
 - ◆ Janitorial Services
 - ◆ Jewelry
 - ◆ Laundry & Dry Cleaning
 - ◆ Lawn/Garden/Agriculture
 - ◆ Maid & Personal Services
 - ◆ Maintenance
 - ◆ Marine Services
 - ◆ Optical Aids & Services
 - ◆ Packaging/Ship/Mail
 - ◆ Painting Services
 - ◆ Paralegal Services
 - ◆ Payroll Services
 - ◆ Pest Control Services
 - ◆ Pet Sales/Supplies
 - ◆ Photography
 - ◆ Printing/Copying
 - ◆ Real Estate Services
 - ◆ Recreational Services
 - ◆ Rental Equipment & Supplies
 - ◆ Retail Stores
 - ◆ Security Systems
 - ◆ Senior Care
 - ◆ Sign Products & Services
 - ◆ Tanning Centers
 - ◆ Telecommunications
 - ◆ Transportation Services
 - ◆ Travel Agents
 - ◆ Vitamin & Mineral Stores
 - ◆ Weight Control
-
- ◆ Insurance

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Well-Known Franchise Names

- ◆ McDonald's
- ◆ Subway
- ◆ Curves
- ◆ Alphagraphics
- ◆ 7-Eleven, Inc.
- ◆ Barbizon School of Modeling
- ◆ Baskin Robbins
- ◆ Big O Tires
- ◆ Blockbuster
- ◆ Century 21 Real Estate
- ◆ Courtyard by Marriott
- ◆ Dairy Queen
- ◆ Dale Carnegie
- ◆ Dunkin' Donuts
- ◆ Kentucky Fried Chicken
- ◆ Fuddruckers
- ◆ Gold's Gym
- ◆ Great Clips
- ◆ H&R Block
- ◆ IHOP – International House of Pancakes
- ◆ Jenny Craig
- ◆ Kwik Copy
- ◆ MAACO
- ◆ Molly Maid
- ◆ New Horizon's Computer Learning
- ◆ Once Upon A Child
- ◆ Papa John's Pizza
- ◆ Radio Shack
- ◆ Seattle's Best Coffee
- ◆ Taco Bell
- ◆ Wild Bird Centers of America

What is a Franchisee?

“Frantrepneur”
(fran*tre*pre*neur) *n.*

A person with the desire to become a franchise business owner and the ability to follow a proven business system for the benefit of his/her own personal and professional gains.

The Frantrepneur Mentality

“I’m in business *for* myself, but not *by* myself”.

“I have the opportunity to learn from the success and failure of others.”

“I want a ‘bottled’ process for success that I can use in developing my own successful business.”

“Why would I work for someone else when I can work for myself and reap the rewards of my efforts?”

"Why would I spend years and the investment required to establish a successful brand when I could buy a franchise which provides immediate access to a successful business system and a brand name which others already have made successful?"

Franchise Options

TYPE:

- ◆ Traditional retail
- ◆ Mobile products/services
- ◆ Work from home

OWNERSHIP:

- ◆ Hands-on
- ◆ Passive
- ◆ Part-time/full-time

OWNERSHIP:

- ◆ Single unit franchise
- ◆ Multiple units
- ◆ Master franchiser
- ◆ Area developer

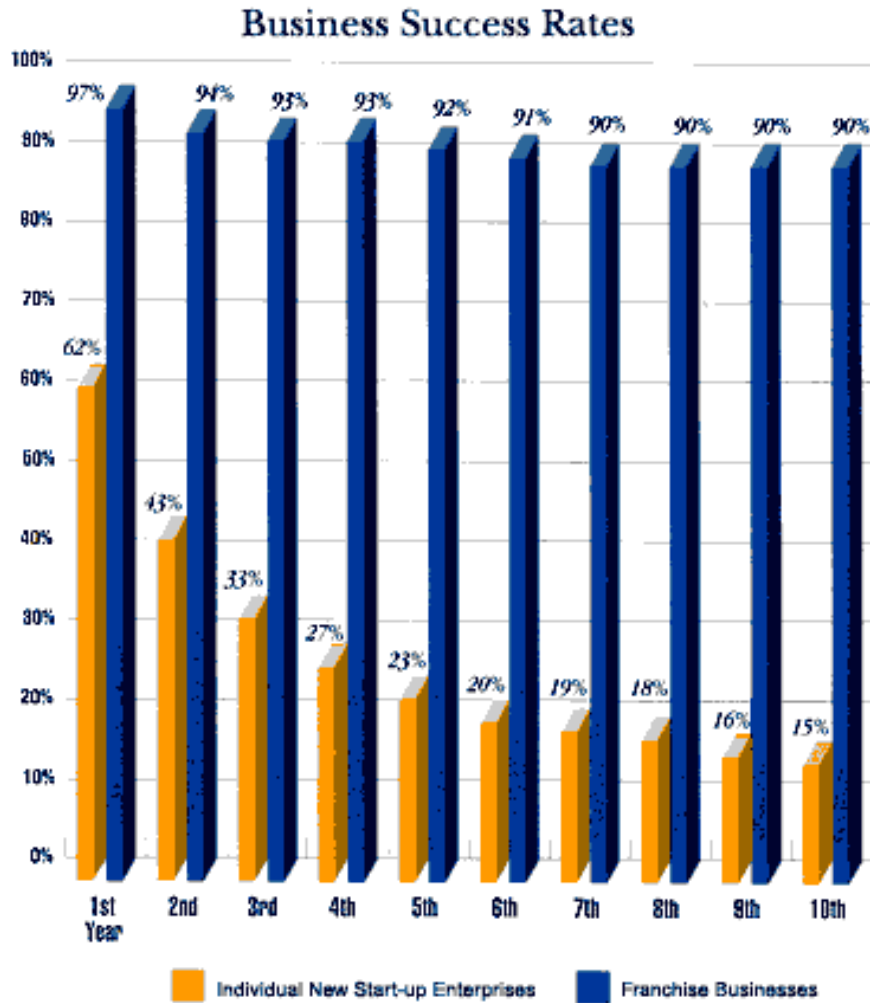
PRODUCT/SERVICE:

- ◆ 75 categories - an endless array of possibilities
- ◆ Something to match anyone's background, skills and interests

Franchise Statistics

- ◆ Franchise businesses account for about 50% of all retail sales in the United States.
- ◆ 1 out of every 12 business is a franchised business.
- ◆ A new franchised business is opened every 8 minutes of every business day.
- ◆ Franchise businesses employ more than 14 million Americans.
- ◆ There are an estimated 6,500 franchise companies operating in the U.S. doing business through more than 316,000 retail outlets.
- ◆ More than 75 industries use franchising to distribute goods and services to consumers.
- ◆ A 1999 study by The United States Chamber of Commerce found that 86% of franchises opened within the last five years were still under the same ownership and 97% of them were still open for business.
- ◆ A U.S. department of commerce study conducted from 1971 to 1997 showed that during that time less than 5% franchise businesses were closed each year. Compare that to a U.S. Small Business Administration study conducted from 1978 to 1998, which found that 62% of non-franchised businesses closed within the first 6 years of their existence due to failure, bankruptcy, etc.
- ◆ Total sales by franchised businesses are projected to reach \$1.7 trillion, this year.
- ◆ In 2000, the median gross annual income, before taxes, of franchisees was in the \$75,000 to \$124,000 range, with over 30% of franchisees earning over \$150,000 per year.

Franchise Success Rate



Statistics compiled from the U.S. Department of Commerce/Industry and Trade Administration and Future Small Business in America

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Franchises have a 97% success rate. Most people can't even predict that they can keep their jobs with a 97% certainty.

Advantages of Buying a Franchise

- ◆ Franchiser business practices are tightly regulated by the federal government
- ◆ Franchisers have a vested interest in **your** success.
- ◆ The marketplace has already been checked out by the franchiser and determined the system to be successful.
- ◆ The franchiser utilizes collective buying power and passes on the discounts to you.
- ◆ Local and national advertising for the franchise operation as a whole is supplied by the franchiser.
- ◆ Supervision, training programs and consulting are readily available from the franchiser.
- ◆ Managerial, operational and accounting systems are in place to facilitate your success.
- ◆ Ongoing research and product development is provided by the franchiser.

Disadvantages of Buying a Franchise

- ◆ You have to pay the franchiser royalties.
- ◆ The contract with the franchiser must be renewed after a certain period of time.
- ◆ There is a lack of flexibility because business methods are dictated by the franchiser.
- ◆ The franchiser's problems are also your problems.
- ◆ You may be obliged to buy products supplied by the franchiser rather than the most cost-effective product available.
- ◇ You don't get to make all of the decisions in how to run your business.
- ◆ In some ways, owning a franchise is like a cross between business ownership and employment.

Established versus Newer Franchises

Possible Advantages of Established Franchises:

- ◆ Name recognition
- ◆ More regional and national advertising
- ◆ Experienced management
- ◆ More refined training and support
- ◆ Better purchasing power with established price discounts

Possible Advantages of Newer Franchises:

- ◆ Exciting, cutting-edge concepts
- ◆ Business may have been designed to avoid mistakes made by older franchises
- ◆ Lower cost of entry and royalties
- ◆ More opportunity to share in equity growth of the company
- ◆ More flexibility and latitude in working with franchisees

Questions To Ask Yourself

- ◆ How much capital do you have to invest?
- ◆ How much liquid assets do you have?
- ◆ Do you require a specific level of annual income?
- ◆ Are you interested in pursuing a particular field?
- ◆ Are you interested in retail sales or performing a service?
- ◆ Do you want a part-time or fulltime opportunity?
- ◆ How many hours are you willing to work?
- ◆ Do you want to operate the business yourself or hire a manager?
- ◆ Do you want to have employees?
- ◆ Do you want to have inventories?
- ◆ Do you want to have Accounts Receivables?
- ◆ Will franchise ownership be your primary source of income or will it supplement your current income?
- ◆ Would you be happy operating the business for the next 10 years?
- ◆ Would you like to own several outlets or only one?

Questions to Ask a Franchiser

- ◆ Determine what assistance the franchiser provides. Do they assist with training, store design, location construction, site selection, and feasibility studies?
- ◆ Do they have any access to demographic studies to get an understanding of the audience within the market area?
- ◆ What types of support will the franchiser provide once your franchise has opened its doors?
- ◆ After the initial investment, will there be additional financial obligations requiring working capital?
- ◆ Does the franchiser offer any form of financing?
- ◆ Ask the franchiser how many franchises have been sold in the state you will be operating in during the last 12 months, and how many have been opened for business?
- ◆ What types of territorial restrictions and protections have been set up by the franchiser?
- ◆ Is the franchiser planning on expanding within your state? Are they focusing on any specific locations?
- ◆ What arrangements are established through the franchiser in terms of product supply?
- ◆ Ask if the franchiser has been forced to terminate any of its franchisees and detail the reasons for this decision. Have any franchisees failed or gone bankrupt?
- ◆ Are there any current lawsuits pending or past judgments against the franchiser? What steps are taken to settle disputes between the franchiser and franchisees?

Questions to Ask Franchisees

- ◆ How long have you owned your franchise?
- ◆ Is your franchise profitable?
- ◆ In which month did you reach your breakeven point?
- ◆ Have you made approximately the same profit that was forecast in the disclosure document?
- ◆ Were your opening costs consistent with the original projections in the disclosure document?
- ◆ Are you satisfied with the franchiser?
- ◆ Are you satisfied with the product or service?
- ◆ Is the operations manual, clear, up-to-date and adequate?
- ◆ Are you satisfied with the marketing and promotional assistance provided by the franchiser?
- ◆ Was the initial training and ongoing support sufficient for you to operate your business?
- ◆ What was your background prior to buying your franchise and was it beneficial to your success?
- ◆ Are deliveries of goods provided by the franchiser timely and competitively priced?
- ◆ Is the franchiser fair and amicable to work with?
- ◆ Does the franchiser listen and help you with your concerns?
- ◆ Have you or other franchisees had any disputes with the franchiser? What was their nature? Were they resolved fairly?
- ◆ Do you know of any disputes between the franchiser and the government?
- ◆ Do you know of any disputes with competitors?
- ◆ Who are the major competitors?

Common Mistakes of Prospective Franchisees

- ◆ Not reading, understanding or asking questions about the FDD (Franchise Disclosure Document), franchise agreement and other legal documents
- ◆ Not understanding the responsibilities of the franchisee and the obligations of the franchiser
- ◆ Not seeking sound legal and financial advisors
- ◆ Not verifying oral representations of the franchiser, representatives or brokers
- ◆ Not contacting enough current franchisees
- ◆ Not contacting closed, sold or changed franchisees and confirming reasons
- ◆ Not having enough working capital
- ◆ Not recognizing the need for financing
- ◆ Not knowing how to make a proper loan request
- ◆ Not developing true and accurate budgets/forecasts and financial statements
- ◆ Not meeting the franchiser's key management and support personnel
- ◆ Not analyzing your market in advance
- ◆ Not developing your marketing strategy
- ◆ Not determining dollar amounts necessary to implement marketing strategy including advertising and promotional programs
- ◆ Not choosing the right location
- ◆ Not analyzing the competition

Should You Use a Franchise Consultant?

A Franchise Consultant should:

- ◆ Never charge you for their services. They are paid by the franchisors, but they recognize that this only happens if they provide you excellent service and present you the right opportunities
- ◆ Take the time to educate you on the franchise industry
- ◆ Help you define your qualifications so that you don't waste your energies and time on franchises that are not right for you or that you are not qualified for
- ◆ Be able provide you valuable insight on franchises that you won't find on your own
- ◆ Help you present your qualifications to a franchise
- ◆ Take an unbiased approach to helping you achieve your goals

The FDD: Pre-Sale Disclosure

Any FDD (Franchise Disclosure Document) contains 23 standard items - this is an important, if not the most important part of your validation process of the franchise company.

- ◆ Description of the franchiser and its predecessors
- ◆ Identity and business experience of officers and directors
- ◆ Litigation and bankruptcy history
- ◆ Bankruptcy history
- ◆ Initial franchise fee and additional costs and fees
- ◆ Franchisee initial investment
- ◆ Other fees
- ◆ Requirements to purchase or lease from designated sources
- ◆ Requirements to purchase from approved suppliers
- ◆ Financing arrangements for franchisees
- ◆ Franchiser's obligations
- ◆ Territorial protection
- ◆ Trademarks, service marks and trade names
- ◆ Patents and copyrights
- ◆ Franchisee requirement to operate the business
- ◆ Restrictions on sale of goods and services
- ◆ Renewal, termination or transfer of the franchise
- ◆ Endorsements by public figures
- ◆ Earnings claims (optional)
- ◆ Names, addresses, and telephone numbers of current and former franchisees
- ◆ Financial statements
- ◆ Copies of the franchise agreement and other contracts and agreements
- ◆ Receipt of the FDD

Common Elements of a Franchise Agreement

- ◆ Grant of Franchise
- ◆ Term of Franchise
- ◆ Name of Franchise
- ◆ Location of Franchise
- ◆ Obligations of Franchise
- ◆ Initial franchise fee
- ◆ Franchise service fees; reporting and audits
- ◆ Advertising fund
- ◆ Training assistance
- ◆ Operation of the business format
- ◆ Representations by franchiser
- ◆ Representations by the franchisee
- ◆ Relationships of the parties
- ◆ Renewal and renewal fee
- ◆ Assignment
- ◆ Termination
- ◆ Procedures after termination
- ◆ Remedies for breach and methods of enforcement of the agreement
- ◆ Attorney Fees
- ◆ Amendment
- ◆ Waiver
- ◆ Approvals
- ◆ Construction and venue
- ◆ Severability
- ◆ Binding to successor
- ◆ Exclusive property

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Directories & Books

- ◆ Franchising for Dummies – Dave Thomas & Michael Seid
- ◆ Tips & Traps When Buying a Franchise – Mary Tomzack
- ◆ Guide to Negotiating a Business Lease – Keith J. Kanouse
- ◆ The Franchise Opportunity Guide
- ◆ Bond's Franchise Guide
- ◆ The Franchise Annual
- ◆ The Franchise Handbook

Associations

- ◆ International Franchise Association
- ◆ American Association of Franchisees and Dealers
- ◆ American Franchise Association
- ◆ Canadian Franchise Association

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*“If you don’t follow your dreams,
you’ll be working for
someone who did”*

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Common Terms

- ◆ Acknowledgement Of Receipt: The last page of an FDD, signed to indicate you received the documents on a certain date.
- ◆ Advertising Fee: An annual fee paid by the franchisee to the franchiser for corporate advertising expenditures; It is often less than three percent of the franchisee's annual sales and typically paid in addition to the royalty fee.
- ◆ Capital Required: The amount of cash you are required to have available.
- ◆ Earnings Claims: Representations made by franchise companies that their franchisees have achieved specific levels of sales or profitability.
- ◆ Exclusive Territory: The "territory" granted to you by a franchise company, which restricts the franchiser from establishing any other location within your area.
- ◆ Federal Trade Commission (FTC): The federal agency in Washington, DC that regulates various trade practices including the franchise industry.
- ◆ Franchise Agreement: An official document that sets forth the expectations and requirements of the franchiser. It describes the franchiser's commitment to the franchisee, and includes information about territorial rights of the franchisee, location requirements, training schedule, fees, general obligations of the franchisee, and general obligations of the franchiser.
- ◆ Franchisee: The owner of one or more franchises.
- ◆ Franchise Fee: The initial fee you pay to a franchiser to acquire a franchise.
- ◆ Franchising: Neither an industry nor a business, but a method of doing business within a given industry. At least two parties are involved in franchising: the franchiser and the franchisee.
- ◆ Franchiser: The person or company that owns or controls the right to grant franchises for a specific "brand".

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- ◆ **FTC Rule 436:** The law passed in 1979 that regulates the franchise industry. It set forth "disclosure" requirements and prohibited franchisers from making earnings claims.
- ◆ **Initial Investment:** Generally, the initial cash investment required of you to buy and open a franchise. This can include the franchise fee and other initial start-up costs and expenses you may incur, but may not be reflective of your total investment.
- ◆ **Liquid Capital:** Also known as, liquid assets, quick assets, and realizable assets. Assets held in cash or in something that can be readily turned into cash.
- ◆ **Master Franchisee:** Describes an individual or company owning the exclusive rights to develop a particular territory for the franchising company.
- ◆ **Net Worth:** Total assets, once you've subtracted your total liabilities.
- ◆ **Non-Compete Clause:** Upon termination, non-renewal, or other sale or transfer, some franchise agreements prohibit you from competing in any way with the franchised company.
- ◆ **Offer:** An oral or written proposal to sell a franchise to a prospective franchisee upon understood general terms and conditions.
- ◆ **Protected Territory:** A designated area or geographic boundary granted to the franchisee by the terms of a franchise agreement. The franchiser promises not to open another franchised or company-owned business of a similar nature within the franchisee's protected territory.
- ◆ **Qualification Questionnaire:** A document prepared by the franchiser to be completed by the prospective franchisee, which provides initial information to the franchiser in order to assist in determining whether or not the prospect is capable and motivated enough to own a franchise. Often a financial statement is included in the questionnaire format.
- ◆ **Registration:** A requirement in several states that specific information be submitted and approved by state regulatory authorities before franchises may be offered in that state. It is quite extensive in the information required and may ask for: a bond, fingerprints and pictures

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- ◆ Start Up Costs: The required amount of money the franchiser will request that a new franchisee have to invest in the new franchise unit in its earliest stages of development.
- ◆ Total Investment: The amount of money estimated for complete set up of a franchisee's business, including the initial investment, the working capital, and any additions to inventory and equipment deemed necessary for a fully operational and profitable business.
- ◆ FDD – Franchise Disclosure Document. Provides background information in over 20 categories as well as a copy of the proposed franchise agreement. Also known as the “Disclosure Document”.

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The Frantreprenuer Mentor helps folks just like yourself, to quickly find and match you with the ideal franchise; one that fits who you are, will work well in your area, you'll enjoy operating and have the opportunity to be highly successful at. Some clients call us a "Franchise Match-Maker". In addition, as a franchise consultant and advisor, I mentor, coach and support you throughout the entire franchise process with regular coaching, communication, mentoring and advice.

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