



What Is Franchising?



Franchising is a licensing arrangement where, for a fee, one person grants another the right to trade under their trademark or name and provides a package of support to enable this, such as training, materials and management advice.

Proven Format

The business for franchising must be proven to be successful and be capable of running on a standard business format. The business must have distinctive brand image and operating systems that set it apart from other businesses in the same area. This is the marketing point behind franchising, as the franchisee will be buying the image to trade under and operate under the specified systems. All franchises will be run by individuals as their own operation, but the systems ensure that customers get standardised treatment as if in one big organisation.

The business must be simple. Complexity will lead to difficulties recruiting, training and keeping franchisees. It also increases the

risk of deviation from the standard business format and the associated risks to brand quality.

There must be an available market for the product or service. Franchises do not tend to work where there is reliance on another party to secure work, such as the dependence on a referral from others in the trade. These businesses are not attractive to a franchisee who will demand a sufficiently certain market in which there is staying power. This also means that franchises dependent on a few large contracts or customers are not attractive.

Pros for Franchiser

The success of a business can be passed on via franchises to develop geographical spread and general growth without high capital risk.

Rapid growth can be achieved without vast amounts of capital. Individual franchisees provide the capital for each new outlet.

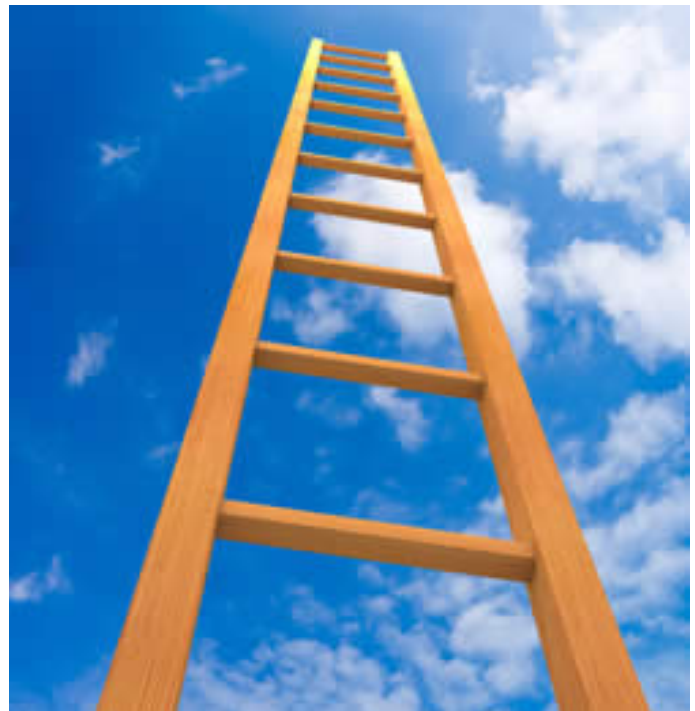
The organisation can exploit areas where it is not already established and make use of franchisees' local interests, knowledge and contacts.

The organisation's innovators can step back and make a reasonable return without having to deal with day-to-day detail and problems which can arise from operating individual outlets.

The franchiser avoids dealing with lots of employees and has fewer personnel problems as each franchise will deal with its own staffing issues.

Security over assets is not an issue for the organisation as each franchisee takes responsibility for assets that they own.

Franchisees will be motivated to reduce costs and maximise profits as this will increase their return. This will in turn increase the returns to the franchiser. Employees may not be as strongly motivated.



Pros for Franchisee

The franchisee does not face the risks inherent with starting up a completely untried business. The product range and operational aspects of the business will have been tested in pilot operations by the franchiser.

The franchisee gets the backing of an established organisation and is helped to run the business so breaking many of the barriers to start-up. Often there will be beneficial trade terms, banking arrangements, etc.

Other Franchise Issues

There is the need to provide continuing support for the franchisee. The support offered will often include:

- Regular trips to franchisee to ensure they are running the business in line with specified systems. This ensures quality control of the brand and helps prevent trading difficulties. Good communication is vital.
- Liaising between franchisees to exchange advice and experience to develop the brand and make improvements to operations
- On-going training and re-training
- Product and concept innovation, including research on how this fits with existing products or services
- Market research
- Advertising – both on local and national level
- Management and accounting advice
- Bulk buying opportunities to take advantage of combined power of franchises

There is a risk that the franchisee will feel so successful that they do not want the franchise but wish to use their acquired skills to go it alone. This can mean competition for the franchise business and loss of franchise income. Agreements to avoid establishing in direct competition for a certain period can be arranged. Avoidance measures would also need to be put in place to include developing a good relationship with the franchisee and making sure that the assistance provided by the franchiser is perceived as adding-value to the franchisee (continuous training, advertising, product development and bulk discounts on materials, etc.). Monahans can help with advice on these issues.

The market perception of the trade name and service is at risk from sub-standard franchises where the product or services do not meet quality expectations. Franchisers need to be aware of this and closely monitor quality levels. The franchiser will also need to be on hand to assist franchisees with problems that if left could have knock-on effects on their services and quality of output. There may be franchisees that do not make the most of the opportunities around them. This is their prerogative as they own the business they are running, but it means that the franchiser is not achieving optimal returns for that area.

There may be problems with obtaining the agreement of the franchisee to up-keep the equipment and replace it in line with the franchiser's intentions and in keeping with the brand image.

Returns to the franchiser are less than if they ran the outlet directly. This must be weighed against the benefits of franchising.

The franchisee may under-declare their income and under pay franchise fees. Some attempt to audit the declared returns may be needed. Advice on accounting controls can be obtained through Monahans.

There may be a lack of interest in people actually wanting to franchise this sort of business. The returns from running the franchise must be perceived to be greater than being employed in the same business. This means that the nature of the business gives relatively high levels of profitability in order to sustain what is effectively an extra tier of ownership.

Establishing the franchise will take time and money and the franchiser is unlikely to see immediate positive cash flows and profits. Manpower and capital will need to be put in to developing the original concept, piloting the idea and marketing and then establishing each franchise agreement, including training. It could take several years before positive results are seen.

Monahans can assist you in assessing the suitability of your existing business for franchising or whether franchising would meet your needs either as a franchiser or a franchisee.

Monahans can also assist with the franchising procedure, again as a franchiser or as a franchisee.



For further advice and assistance

Our specialist Corporate Finance department will be pleased to help.

Please contact **Peter Lugg** on **01225 472800** or email **peterl@monahans.co.uk**.