Taking the franchise route

i'm lovin' it

Geoffrey Stanford considers the benefits and pitfalls of operating a franchise as opposed to starting a completely new business

Many people dream of owning their own business, but in reality that dream can rapidly become a nightmare. On average, one in every two start-up businesses is likely to fail within the first 2 to 3 years, but one industry sector is bucking that trend — franchising. The British Franchise Association (BFA), in conjunction with the NatWest Bank, produces an annual survey about franchising. The survey has consistently shown that the failure rate of franchisees is substantially better than the failure rate for independent small business start-ups, with 91% of franchises being profitable last year from an average turnover of £360,000.

According to the NatWest/BFA survey, franchising turnover has grown at an average annual rate of almost 11% over the last 3 years (see Figure 1). Franchise companies now turn over some £12.4 billion per year and employ over 370,000 people. That is more people than all the armed services put together and more revenue than tourism generates.

TOPFOTO

What is franchising?

Franchising is the granting of a license by one person (the franchisor) to another (the franchisee), which entitles the franchisee to trade using the brand name of the franchisor. Many of our best-known brands are franchised — Thorntons confectionery, Toni & Guy hairdressing, Blockbuster video rental, Kall-Kwik printing — to name a few. In the early days, franchising was concentrated in a limited number of markets, such as fast food (McDonald's, PizzaHut, Subway), hotels and motor distribution. Now, numerous different business sectors are represented. The BFA recognises approximately 800 business format franchises in the UK, comprising over 34,000 franchisees.

Franchisees receive training and assistance from the franchisor and benefit from their experience in helping them to grow their business. Even though franchising is a much safer way to own your own business, that increased peace of mind comes at a price — you sacrifice much of your independence.

Each business outlet is owned and operated by the franchisee, but the franchisor retains control over the way in which products and services are marketed and sold to ensure quality standards are maintained. The franchisor will therefore 'police' its franchisees to protect its brand and will not tolerate any deviation from the proven system. For example, a franchisee would not be able to put a different sauce in a Big Mac. Nonetheless, the franchisor and its franchisees are exposed to the actions of the weakest franchisee, who may cut corners or deviate from the system to save a few pounds. Food franchises are particularly vulnerable: one case of food poisoning detracts from the whole brand, not just the outlet where it occurred.

Starting up as a franchisee

Starting a franchise can offer considerable financial advantages over starting up an independent business. For example, as a franchisee, you are using a tried and trusted business model, giving you the benefit of the franchisor's knowledge, and you have the support of the franchisor's supply chain, which can bring benefits through bulk buying.

The cost of setting up as a franchise ranges from £25,000 to £250,000, with the average being £170,000. Borrowing for a franchise is mostly financed through banks, which normally expect the franchisee to contribute at least 30% of the cost of the franchise from their own money. However, banks will rarely offer this level of funding to an independent business as the risk is so much higher. Major banks all have large franchising departments as they realise that lending money to a franchisee carries far less risk.

The franchise contract

The alliance between a franchisor and a franchisee is confirmed in a contract known as the franchise agreement. This contract is agreed for a fixed term, usually 5 years, with an option to renew for a further 5 years, but some can be longer. Franchise agreements often contain a number of generic clauses, for example, setting out fee structures, territory rights and the obligations of both the franchisor and the franchisee.

Franchise agreements are often viewed with suspicion by franchisees, yet they are fundamental to their success and that of the franchise network. The aim of the agreement is to ensure that the nature of the relationship between the franchisor and franchisee is clear. Potential franchisees also need to be aware that the contract is non-negotiable — the agreement they are signing is the same for everyone.

Training and support

Franchisors are increasingly aware that the success of any franchise depends on them providing training and support that will enable each franchisee to contribute to the success of the network. A formal training programme provided to all franchisees before they start trading has become the industry norm. Initial franchise training typically lasts between 2 and 3 weeks, although at Pizza Hut, for example, all new applicants undertake a 12-week training programme prior to the opening of their business. Not only does good training give new franchisees the confidence and knowledge to run a new business, it can also help them realise their true potential.

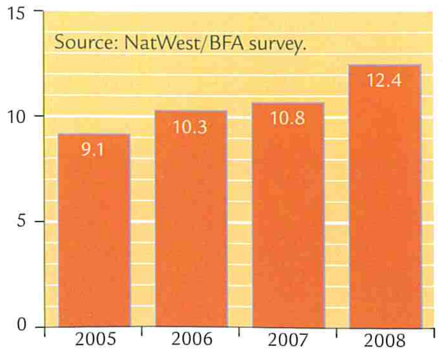

Figure 1 *Total sales turnover of UK franchise businesses (£ billions)*

Table 1 *Advantages and disadvantages of starting up a franchise*

Advantages	Disadvantages
Franchisees don't have to come up with a new idea — someone else has done it, and tested it too.	Starting up a franchise requires a significant amount of time and money.
Larger, well-established franchise companies will often have national advertising campaigns and a solid trading name.	Franchisees have to pay a fee to the franchisor, which reduces the franchisee's profit margin.
Good franchisors will offer comprehensive training programmes in sales and other business skills.	Franchisees have less control as they have to operate within the constraints of the franchise agreement,
Franchisees often benefit from the lower cost of supplies owing to the franchisor's purchasing power.	

Box 1 *Chemex franchisee winners*

Stephen and Margaret Crinks bought their Chemex franchise nearly 15 years ago and in 2007 reached the finals of the British Franchise Association's prestigious Franchisee of the Year awards. Stephen says: 'One of the main attractions of franchising for us was the ability to share knowledge. Fifteen years on we still take up others' ideas and we work closely with new franchisees as we still remember what it was like in the early days. Delivering first-class customer service is everything — our success is built upon it. We build long-term relationships so our customers can't imagine going anywhere else.'

Stephen, a former hotel manager and Margaret, a former PA, have achieved unwavering customer loyalty. As Margaret says: 'We pride ourselves in never having lost a customer in those 15 years. We operate in an industry that requires our products year-round and we aim to get regular repeat business. The cleaning chemical industry is very competitive and there are many companies offering high-quality products, so we needed an approach that would really set us apart.'

Source: www.chemexfranchises.co.uk

The franchise fee

It is important for a franchisee to consider the charges being levied by the franchiser. The majority of franchisers charge an initial fee plus a percentage of their franchisees' turnover or mark-ups on supplies. This is largely seen as the fairest way to both parties, but some levy a fixed weekly or monthly fee, irrespective of the franchisees' revenue. In return, the franchisor has an obligation to support the franchise network, notably with training, product development, advertising, promotional activities and with a range of management services.

Set at the right level for a particular business, and with an appropriate range of safeguards, a fixed fee can offer real advantages, not least of which is the fact that franchisees perceive real value for money as their business grows but their payments to their franchisor don't. However, set at the wrong level for a business and administered without adequate safeguards, fixed fees can be a millstone around a failing franchisee's neck and a licence for an irresponsible franchisor to print money.

Benefits to consumers

In an age where the customer is king, businesses must go to extraordinary lengths to make customer service their top priority. This is one area where franchise owners have a huge advantage over independent companies. The consumer benefits from the owner/operator's commitment to excellence and the back-up from a national brand. They get reliability; they know what to expect and they get it. What will appeal more to the hungry consumer walking down the high street in an unfamiliar town or city — Joe's Burgers or a McDonald's?

Weblinks

- The British Franchise Association: www.thebfa.org
- The *Daily Express* franchise site: www.dailyexpressfranchise.co.uk

Geoffrey Stanford teaches business studies at Millfield School and is an A-level examiner. He would like to thank Chemex for the help provided in writing this article.