

Early Decisions

Chapter 5

Franchising

Franchising Systems

- Product-Distribution Franchising
 - Allows the franchisee (dealer) to buy products from the franchisor (supplier) or to license the use of its trade name
 - Connects a single manufacturer with many dealers to make products available to consumers in a specific geographic region through exclusive dealers
 - Soft-drink bottlers, gasoline stations, and car dealerships

Source: Hatten, Small Business Management, 4th Edition

About Franchising

- Franchise
 - Contractual license to operate an individually owned business as part of a larger chain
- Franchisor
 - Parent firm that develops a product or business process and sells the rights to franchisees
- Franchisee
 - Small business person who purchases the franchise in order to sell the product or service of the franchisor

Source: Hatten, Small Business Management, 4th Edition

Franchising Systems (cont'd)

- Business-Format Franchising
 - Is a turnkey approach
 - Franchisee purchases the franchisor's product to sell, along with the franchisor's entire way of doing business—operation procedures, marketing packages, physical building and equipment, and full business services
 - Used in quick-service restaurants, lodging, retail food, and table/full-service restaurants
 - Hotel and motel chains, McDonald's

Source: Hatten, Small Business Management, 4th Edition

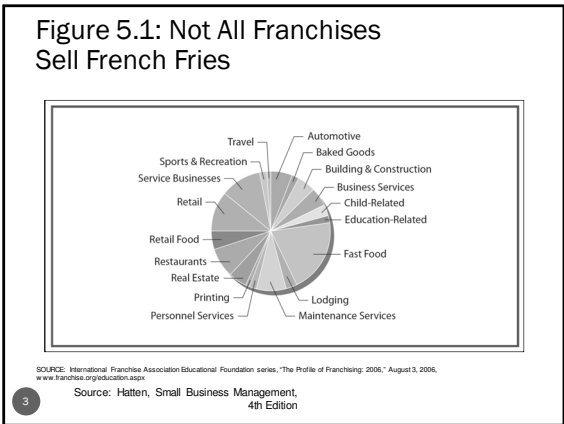


Table 5.1: The Advantages and Disadvantages of Franchising

Franchisee's Perspective	Franchisor's Perspective
Advantages	Advantages
1. Proven product or service	1. Expansion with limited capital
2. Marketing expertise	2. Multiple sources of capital
3. Financial assistance	3. Controlled expansion
4. Technical and managerial assistance	4. Motivated franchisees
5. Opportunity to learn business	5. Bulk-purchasing discounts
6. Quality control standards	
7. Efficiency	
8. Opportunity for growth	
Disadvantages	Disadvantages
1. Fees and profit sharing	1. Loss of control
2. Restrictions of freedom	2. Sharing profit with franchisees
3. Overdependence or unsatisfied expectations	3. Potential for disputes with franchisees
4. Risk of fraud or misunderstanding	
5. Termination of the agreement	
6. Performance of other franchisees	

Source: Hatten, Small Business Management, 4th Edition

Table 5.2: Getting In

Franchise	Franchise Startup Fee	Costs	Royalty (Percentage)
Master Auto Painting & Bodyworks	\$40,000	\$266,500	6%
Maxima Car Care Centers	\$30,000	\$180,000-200,000	3%-7%
Jazzercise	\$25,000	\$2,000-31,000	Up to 20%
Sign-A-Rama	\$30,000	\$90,000-144,000	6%
Big Apple Bagels	\$25,000	\$220,000-307,500	5%
Rocky Mountain Chocolate Factory	\$24,000	\$120,000-420,000	6%
Bad Ass Coffee	\$25,000	\$225,000	6%
Cold Stone Creamery	\$42,000	\$294,300-430,500	6%
Taco Time	\$30,000	\$120,000-480,500	6%
Subway	\$15,000	\$74,900-220,000	6%
Wilton Cakes and Resorts	\$60,000	\$200-500	5%
Merry Maids	\$10,000-27,000	\$24,400-50,500	5%-7%
It's Just Lunch Dating Service	\$25,000-20,000	\$90,000-170,000	9%
McDonald's	\$45,000	\$900,000-1,600,000	12.5% or more
Cartridge World	\$30,000	\$107,300-170,500	6%
Century 21 Real Estate	\$20,000	\$100,000-500,000	6%
Kaplan Math & Reading Centers	\$1,000	\$10,200-20,700	\$20-150/student/line
Play It Again Sports	\$20,000	\$100,200-301,000	6%

Source: Hatten, Small Business Management, 4th Edition

Selecting a Franchise (cont'd)

- Do Your Research (cont'd)
- Other Information Sources
 - American Franchise Association (AFA)
 - American Association of Franchisees and Dealers (AAFD)
 - Online information—FranNet, Franchise Handbook Online, ABI-INFORM, etc.
 - Better Business Bureau
 - Institute of Management and Administration

Source: Hatten, Small Business Management, 4th Edition

Selecting a Franchise

- Evaluate Your Needs
 - How much equity capital is required to purchase and operate the franchise until income equals expenses?
 - Where will the equity capital come from?
 - Are you prepared to give up some independence of action for the advantages offered by the franchise?
 - Do you have the ability, training, and experience to work with the franchisor, employees, and customers?
 - Are you ready to make a long-term commitment to working with the franchisor, offering its product or service to your public?

Source: Hatten, Small Business Management, 4th Edition

Selecting a Franchise (cont'd)

- Do Your Research (cont'd)
 - Ask questions; assume nothing
 - Personally analyze the potential market for the franchise
 - Review the disclosure statements carefully
 - The franchisor wrote the contract and most of the contract conditions are weighted in its favor.
 - NEVER sign a franchise agreement without getting a lawyer's opinion.
 - MAKE SURE that an attorney and accountant have experience with franchising.

Source: Hatten, Small Business Management, 4th Edition

Selecting a Franchise (cont'd)

- Do Your Research
 - General Business Periodicals
 - *Inc.*, *Fortune Small Business*, *The Wall Street Journal*, *Success*, and *Entrepreneur*
 - Specialized Journals & Magazines
 - *Franchise*, *Franchising Opportunities World*, and *Quarterly Franchising World*
 - Trade Associations
 - International Franchise Association (IFA)
 - Canadian Franchise Association (CFA)

Source: Hatten, Small Business Management, 4th Edition

Disclosure Statement Items

Disclosure statement items required by the Uniform Franchise Offering Circular (UFOC) issued by the Federal Trade Commission

- | | |
|--------------------------------------|----------------------------------------------------------------|
| 1. The franchisor | 12. Renewal, termination, or assignment of franchise agreement |
| 2. Business experience of franchisor | 13. Training provided |
| 3. Litigation | 14. Public figure arrangements |
| 4. Bankruptcy | 15. Site selection |
| 5. Initial fee | 16. information about franchisees |
| 6. Other fees | 17. Franchisor financial statements |
| 7. Estimate of total investment | 18. Personal participation of franchisees |
| 8. Purchase obligations | 19. Earning capacity |
| 9. Financial assistance available | 20. Use of intellectual property |
| 10. Product or service restrictions | |
| 11. Exclusive territory | |

Source: Hatten, Small Business Management, 4th Edition

Figure 5.2: Franchise Disclosure Statement



13 Source: Hatten, Small Business Management, 4th Edition
Source: Hatten, Small Business Management, 4th Edition, www.franchisinghandbook.com/individual-company-web-pages.

Selecting a Franchise (cont'd)

- The Franchise Agreement
 - The legal contract that binds both parties involved in the franchise and that spells out the rights and obligations of both parties.
- Franchise fee
 - A one-time payment to become a franchisee
- Royalty fee
 - Ongoing payments to the franchisor; usually a percentage of sales.
- Advertising fees
 - Fees paid to the franchisor for advertising

14 Source: Hatten, Small Business Management, 4th Edition

International Franchising

- International Franchising Is Growing
 - Overseas franchising is more attractive as domestic competition increases in saturated local markets.
 - 95% of the world's consumers live outside the U.S.
 - Foreign consumers already know U.S. products.
 - Foreign governments are enacting disclosure laws.

15 Source: Hatten, Small Business Management, 4th Edition