

Franchise: The Fundamentals of Franchising Development:

What is franchising and how does it work?

There is more than one kind of franchising, but here is a basic description of what "business-format" franchising is.

Franchising is a method of business expansion whereby a business owner or manager allows someone to market products or services under their name and trademark and in strict adherence to a system he/she prescribes. In return, the franchisee, as that person (or organization) is called, pays a fee and, usually, an ongoing royalty. Moreover, the franchisee pays all of the costs of getting into your own business.

In the 1960s – before Ray Kroc and McDonalds, before Seven/Eleven, Subway, Pizza Hut, and all the other successful franchise companies established franchising as a legitimate industry – all of those negative things were being said and done about franchising. Yes, there was even a move in Congress to outlaw franchising.

And today...? Today, many experts say the franchising industry is responsible for more than 50 percent of all the goods and services we buy and sell at retail in the United States alone – One Trillion Dollars worth! Not bad for what just a few years ago was labelled "a scam and a scheme."

Let's take a closer look at franchising. Franchising truly was a revolutionary business concept – and it still is. Take a look at your alternative: 80 percent of all small businesses fail in their first year. 80 percent of those that make it, don't survive to see year five – and of those that do, even fewer will last another five.

Franchising as a strategy for growth in your Business

- Franchising is a way for the small business entrepreneur to boost the odds of success.
- A franchise takes the guesswork out of building a business from scratch.
- The franchise company creates a "turn-key opportunity" – a ready-made business, complete with products or services, training, vendors, policies and procedures.
- Virtually anyone with the desire and start-up capital can climb into this vehicle, turn the key, and drive off down the highway of entrepreneurial success.

It's truly brilliant. You don't need to know all there is to know about building a franchise to own one. The franchise company has done all that work for you.

You simply pay your franchise fee, build or rent your location and furnish it with the equipment the company has already designed and successfully tested for you, hire your people, and then pay the company a percentage of your sales and profits.

Other strategies for expansion are as follows:

- **Licensing.**
- **Network marketing**
- **Mergers and acquisitions.**

Why Franchise? The merits of Business franchise.

1. Because for many businesses, slow growth isn't an option any more.

It used to be that for businesses that wanted to replicate existing locations, a slow growth method was perfectly acceptable. A business generating 20% return could replicate itself within five years. In ten years, it might have several company-owned stores.

But times have changed. Chains now dominate the marketplace in virtually every retail segment.

The independent business that chooses slow growth may soon find itself surrounded by fast growing, heavily advertised, well-known competitors. Before those five years is up, a 20% return could be down to 0%. In short, today an increasing number of businesses, the choice is not between growing slow or growing fast. The choice is between growing fast and closing down.

2. Because the cost of outside capital is too high.

Company-owned expansion can be accelerated, of course, with outside capital. But borrowing money isn't as easy as it once was. Banks used to loan \$5 for every \$1 of net worth. In recent years that ratio has dropped to 2 to 1 and currently it's closer to 1 to 1. Lower interest rates haven't helped either.

They've actually hurt! Bankers ask themselves, "Why lend to businesses and assume relatively high risk when we can put our money in government bonds and get almost the same interest with no risk?" Gradually, the pool of lending capital for business expansion has dwindled.

Investors can be a source of outside capital and some successful businesses do go to the stock market or to Venture Capital. But at what price? In exchange for investment capital a business owner must give up equity—a share of the business. Giving up a share of the business usually means giving up a share of control. Worse, if growth isn't achieved on schedule, it can mean giving up all control. Partnerships and Joint Ventures require giving up some control in the decisions and strategy for growth.

Family and friends are also an option. While they are usually more understanding and may not ask for a vote in management decisions, all too easily, tensions can arise and cause problems.

Even if outside capital can be raised, the process of company-owned growth can be fairly slow. Locations must be pinned down. Facilities must be leased or built. Managers and employees must be hired. And a single managerial team must make every decision.

3. Because of MTP—the franchise advantage.

Again why franchise?

- Because franchising avoids the problems of slow growth.
- The problems of outside capital.
- The problems of finding the right employees. In short, franchising solves the problems of MTP -Money, Time and People.

And it does so in creative ways:

- **Money:** Franchising transfers almost the entire cost of expansion to franchisees. Franchisees build the building or pay the rent, buy the inventory, pay the employees and provide the working capital until sales make the business profitable.
- **Time:** Anxious to move quickly before the competition catches on? Got a hot, new concept? Want to exploit a new marketing opportunity? Franchising is the one growth system that allows businesses to expand exponentially.

A franchise can grow fast simply by selling individual units. Some franchises can grow even faster by selling multiple units or territories to sub franchisees.

Either way, it is usually faster to open franchises than company-owned units.

- **People:** "A good manager is hard to find." Not exactly an original idea. Franchisees make excellent managers, studies show. Why? Because they have a vested interest in the business, they own it.

Through franchising, a company gets both dedicated managers and relief from the problems associated with hiring and firing personnel.

Franchising has other advantages too

- **Lower Risk.** Because franchisees provide investment capital and accept most of the legal and operational risks involved in setting up a business, you assume less risk at the unit level.
- **Buying Power.** As the company expands, negotiating power on products, supplies, and services increases, helping all the locations in the system-franchises and company-owned.
- **Quality Control.** Franchisees can be legally required to follow the franchisor's business system
- **A Strategy for running your business better.** Franchising gives talented executives the opportunity to focus on big picture issues, rather than the exhausting day-to-day administration.
- **A solution to dealer problems.** Under performing, unenthusiastic dealers can be replaced with vested, hard-working franchisees.
- **An exit strategy.** With its growth and profitability potential enhanced, a firm can become a much more saleable commodity.

Franchising combines limited risk with profit potential and short-term growth with long-term stability.

The popularity of franchising is no accident. It is the most entrepreneurial of all growth systems because it allows more people to become business owners than any other system. That's why franchising is "**the American Dream with a Safety Net**"...franchisees get the benefit of being in business for themselves, but not by themselves.

According to its critics, the truth is about one third of all franchises fail. Another third break even and only one third make a profit. In fact some franchise veterans say you can't make money in franchising today unless you own five individual franchise units or more! Still, that's a much better average than the 80/20 failure/success rate of conventional small businesses.

The Demerits of Business Franchise

- High Capital Investment – High Risk Involve.
- Many Employees required and there's problem, firing or managing employees.
- Payment of royalties may be required.
- There are none all-consuming demands of a seven-day work-week and 15-hour-a-day retail operation.
- There's the independence of choice: choosing with whom you work, when, where and how you work.

Who Should Franchise?

“Franchising is a business model that is used in over 70 industries and generates over \$1 trillion in US sales annually”

Despite the impressive merits of franchising, not every business should franchise. Here are a few characteristics of businesses that may not be suited for franchising:

- Complex operations.
- Low margins.
- New, unproven businesses.
- Businesses that require large numbers of employees.

- Difficult to monitor from long distances

On the other hand, some business characteristics lend themselves very well to franchising:

- A good track record of profitability and competitive advantage.
- A unique or unusual concept.
- Broad geographical appeal.
- Relatively inexpensive to operate.
- Relatively easy to operate.
- Readily duplicated.

The decision whether or not to franchise is not easily made. But DeJUZ Consulting can help to address the business issues, weigh the "pros" and "cons," so that you can make a decision from an informed perspective.

Conclusion:

Moving forward, I believe that businesses will seek even more innovative and growth strategic ways to expand and capture the full value of your business. Your presence here today is a clear signal that the message of franchising as a strategy for growth increasingly beginning to be heard. And it is those that seize the opportunities, leverage on their intellectual assets and learn the rules of the game in the business playing field that will reap the maximum benefits.

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