EXPANDING YOUR BUSINESS BY FRANCHISING

As you consider expanding your business keep in mind that of the alternative methods of business expansion, franchising is more than likely the best model for you. **The primary barrier to expansion faced by today's business person is capital.** Franchising allows companies to expand without the risk of debt or the cost of equity. Franchising is also an excellent method of distribution as compared to alternative methods.

Whether to expand at all should, of course, precede consideration of the method. Many businesses are not easily duplicated into a network of outlets. Many entrepreneurs are not temperamentally suited to manage expansion and will be happier, and probably more successful, operating their original businesses or growing only to a second or third outlet in the same city.

Once the decision to expand is made (Step 1), the different methods by which expansion can be accomplished will need to be considered. One obvious method is the establishment of additional outlets patterned on the original business and financed with its net cash flow, debt, equity from friends and relatives or a combination of one or more of these sources. Expansion by this method is slow, requires large amounts of capital, and may strain the management. A variation on this method would be the establishment of joint ventures, either with passive investors or active operators to ensure that owner-operators will be responsible for the management of each outlet. Finally, the business owner will likely consider franchising.

The selection of the method(s) of expansion can be considered Step 2. The method chosen is likely to be influenced in part by the goals of the business owner. If the goal is to build a statewide, regional or national network of outlets, franchising is the logical choice.

The selection of franchising as an expansion method should be made subject to meeting certain criteria, which also must be met before we consider taking you as a client of Franchise Development Group. Please fill out the attached Questionnaire "Could Your Business Be Franchised?" which we will go over with you at our next meeting.

The following information has been developed by the International Franchise Association through its legal counsel DLA Piper US LLP

Relatively low entry barriers have made franchising an attractive method of business expansion.

A franchisor does not require large amounts of capital to develop and implement a franchise expansion program.

Franchising is essentially a method of distribution that combines some of the advantages of an integrated corporate network with those inherent in independently owned and operated businesses. A franchisor does not have to acquire and deploy the capital, manpower or organization of a vertically integrated chain. The franchisor is able to obtain the benefits of franchisee financed growth, owner management and avoidance of the costs of centralized management.

The **benefits** usually attributed **to franchising as a *superior* method of business expansion** fall into **two general categories**:

1. **Benefits relating to the capital investment furnished by franchisees to develop retail outlets and expand the franchisor's network:**

   a. Rapid expansion of the franchisee network

   Franchising enables a company to establish a large number of business outlets in a relatively short time period. The capital and part of the work to locate and acquire sites and develop outlets is supplied by the franchisee.

   In most situations, a franchisor does not have the asset base or business experience to raise the amount of capital that will be furnished by its franchisees to expand the franchise network.

   b. Franchisees share the risk of expansion of the franchise network

   Franchisees furnish most of the capital required to expand the franchisor's network. The franchisee furnishes equity and borrowed capital to pay for real estate, leasehold improvements, equipment, fixtures, furnishings, inventory and working capital required to establish the franchisee's outlet.

   The franchisor's cost of expansion is usually limited to the overhead costs associated with site selection, franchisee recruitment, training and pre-opening assistance that are not covered by the initial franchise fees.

   c. A franchising company can realize a higher return on its capital

   Because the investment in the development of outlets is typically made by franchisees, a franchisor is able to operate with few fixed assets other than the outlets that it owns. Therefore, though its revenue from franchised outlets (composed primarily of fees and product sales to franchisees) is substantially lower than it would be from owned outlets, a higher percentage of the revenue is profit and that profit is generated with a much lower capital investment, resulting in a potentially very high rate of return on invested capital.

d. Franchise networks can realize economies achieved by company-owned outlets through joint procurement

Franchisors typically develop supply programs for equipment, fixtures, furnishings, signs, supplies, insurance, marketing and advertising services required by their franchisees. Such programs can furnish to a franchise network the advantages of combined purchasing power enjoyed by a network of company-owned outlets.

e. Reacquisition of franchised businesses

A successful regional or national franchisor is in a position to buy back franchisee owned businesses to expand the number of franchisor owned and operated businesses in the network.

2. **Benefits related to the motivated management by franchisees of the business in which they have made substantial investments.**

a. Franchisees are motivated owner-managers

In a franchise network, the business plan is executed by business owners, not employed managers. A franchisee has a direct and continuing financial interest in, and a commitment to his/her business and is usually a motivated manager. A franchise offers such persons the opportunity to become a business owner in a network of businesses operating under a common trade industry, with tested and successful (at least in a local or regional market) operating and marketing systems and training, continuing support, economies of joint procurement and other services available to franchisees. Also attractive is the relative low cost and finance ability of many franchised businesses.

b. **Franchisees are idea/information resources to a franchisor**

A business owner generally has a higher level of motivation to innovate than a non-owner-manager. Franchisees are a productive source of new products, services, operating methods and marketing concepts.

c. A franchising company has a simpler and more efficient management structure

A franchisor is an administrator and service provider, furnishing information and other services to its franchisees. A franchisor needs fewer levels of management.

d.   Franchising offers opportunities for employees to acquire franchises.

Franchisors can offer franchises to experienced employees and thereby reduce the ‘dead end job’ syndrome and motivate employees that have reached their highest likely management level. Experienced employees frequently make productive franchise owners.

The “Key to Owning Your Future” is as Tom Watson, founder of IBM said:
Don’t do business....build one!

The **true product** of a business is **not what it sells but <u>how</u> it sells it.**
The true product of your business is the business itself.

Could Your Business be Franchised?

QUESTIONNAIRE

The following questions help you and us determine if you meet the basic criteria and willingness to expand your business through franchising.

Keep in mind that no one is ready to franchise *until* they have gone through the process. But there are some criteria to determine if there is a *likelihood of success*. Answer these questions and see how you measure up.

1. **Are you credible?**

Credibility is reflected in a number of ways: size, number of units, years in operation, look, public awareness, profitability, strength of management, public satisfaction, etc. **Y** □ **N** □
Please explain your answer.

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2. **Are you sufficiently different?**

This comes in the form of quality and/or need of the product or service, a reduced investment cost, a unique marketing strategy, target markets, a great system, a unique name and/or brand, etc. **Y** □ **N** □ Please explain your answer.

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3. **Can your knowledge be transferred?**

Can you teach your system to others? Generally speaking if the business is so complex that it cannot be taught to a franchisee in 3 months, it may be difficult to franchise. **Y** □ **N** □
Please explain your answer.

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4. **Can your business concept be adapted from one location to another?**

Issues such as state laws and regulations, consumer tastes or preferences, unique locations, or the talents of the person behind the concept should be considered. Another factor of adaptability is the anticipated size of your franchise system (over 50% of all franchised companies have 50 or fewer franchisees--you don't have to have thousands or even hundreds of franchises, and don't have to be national or even regional). **Y** □ **N** □ Please explain your answer.

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5. **Is your system proven?**

In other words, your system works, and while it may need to be refined, it is a successful prototype. This does not mean that you have to have more than one location. Many people think they have to open more outlets and prove them before they can franchise. This is not true.

Y □ **N** □ Please explain your answer.

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6. **Is your system documented?**

While all successful businesses have systems, not all are adequately documented. (We help you document your policies, procedures, systems, forms and business practices in a comprehensive, user-friendly, operations manual and/or a computer-based training module.) **Y** □ **N** □

Please explain your answer.

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7. **Is your system affordable?**

Affordability reflects a prospective franchisee's ability to purchase your franchise, and not just the actual cost of the franchise. **Y** □ **N** □ Please explain your answer.

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8. **Will your franchisee receive a return on investment?**

This is the real acid test of franchisability. A franchise must be profitable, but profitable after your royalties are paid. (Profitable also includes the franchisee being able to make an income.) Profitability is always relative, and must be measured against other investments of comparable risk that compete for the dollar. **Y** □ **N** □ Please explain your answer.

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9. **Are there market trends and conditions that will affect your franchise?**

While not an indicator of franchisability, trends are a key to planning and timing. Will you miss out by waiting? **Y** □ **N** □ Please explain your answer.

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10. **Do you have the capital to franchise?**

While franchising is a low cost means of expanding a business, it does cost. You will need the capital and resources to develop a franchise program. **Y** □ **N** □

Please explain your answer.

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11. **Do you have a commitment to relationships?**

Successful franchisors focus on building relationships with their franchisees that are mutually rewarding. Strong relationships enable you to sell franchises more readily and introduce needed changes into the system more easily. **Y** □ **N** □ Please explain your answer

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12. **Do you have the strength of management?**

This is probably the single most important component. A single most common contributor to the failure of franchisors is understaffing and lack of experience. (Again we help in the areas where you may not have the experience, or need the assistance, such as franchise sales, lead development, advertising fund management, franchise training, operations, etc.) **Y** □ **N** □ Please explain your answer.

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How did you do? Can you say that you are a franchise candidate?

Y □ **N** □ Please explain your answer.

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Franchise Development Group is unique in the franchise consultation business because we become your partner throughout the entire franchise process, which generally consists of four phases:

1. Defining the Franchise Offering
2. Operations
3. Marketing and Awarding Franchises
4. Becoming a Franchise Company

Our Proposal will include all the details about what we provide for you and what it will cost you, and in the meantime you can get more information about our services and why we are the best choice to be your franchise consultants.

Franchise Development Group is a group of highly trained professionals, businessmen and marketing experts.

Andy Klie, President, holds an MBA in Finance from University of North Carolina Charlotte and a BS in Business Management from Indiana University of Pennsylvania. He has over 15 years experience in franchising and has helped award over 500 franchises for both emerging and established franchise concepts.

For a no cost analysis of whether your business can and should franchise contact him at (716) 208-6900 or aklie@franchisedevelopmentgroup.com