

## SHOULD I FRANCHISE MY BUSINESS?

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Have a better mousetrap and scared to death that the world actually is beating a path to your door? People walking through your operation with notepads and cameras? Trouble sleeping at night wondering who will knock off your operation first? Certain that yours is the next Ray Kroc story, if only you could get the capital? Tired of reading about companies and thinking, "I have a better franchise concept than that company."?

Maybe you, too, should consider franchising.

### WHY FRANCHISE?

In general, companies franchise for one of three reasons: time, people, or money.

The primary barrier to expansion faced by today's businessperson is capital. And franchising allows companies to expand without the risk of debt or the cost of equity. Since the franchisee provides the initial investment at the unit level, franchising allows for expansion with minimal capital. Moreover, since it is the franchisee, and not the franchisor, who signs leases and commits to various service contracts, franchising also allows for expansion with virtually no contingent liability, thus greatly reducing the risk to the franchisor.

Another barrier to expansion facing many of today's businesses is finding and retaining good unit managers. All too often, a business owner spends months looking for and training a new manager only to see that manager leave -- or worse yet, hired away by a competitor.

Franchising allows the business owner to overcome many of these problems by substituting a motivated franchisee for the unit manager. Interestingly enough, since the franchisee has both an investment in the unit and a stake in the profits, unit performance will often improve. And since a franchisor's income is based on the franchisee's gross sales, and not profitability, monitoring unit level expenses becomes significantly less cumbersome.

Finally, opening a unit takes time. Hunt for sites. Negotiate leases. Arrange for design and build-out. Secure financing. Hire and train staff. Purchase equipment and inventory. The end result is that the number of units you can open in any given period of time is limited.

For companies with too little time (or too little staff), franchising is often the fastest way to grow. That's because it is the franchisee that performs most of these tasks. The franchisor provides the guidance, of course, and the franchisee does the legwork. Thus, franchising not only allows the franchisor financial leverage, but it allows him to leverage his resources as well.

BUT IS MY BUSINESS "FRANCHISABLE?"

Franchising is a relatively flexible format, and just about any type of business can be franchised, provided it meets some basic characteristics:

It needs to be credible. Does it have experienced management? A track-record over time? Is the concept proven? Has it achieved good local press or public acclaim?

It needs to be unique. Is it adequately differentiated from competitors? Is it marketable as a business opportunity? Does it have a sustainable competitive advantage?

It needs to be teachable. Are the systems in place? Are operating procedures documented? Could someone learn to operate the business in three months or less?

And it needs to provide an adequate return. Not just profitability. If a business cannot generate a 15% - 20% return on investment after deducting a royalty (typically between 4% and 8%), it is going to have difficulty keeping franchisees happy.

If your business meets these criteria, then it may be a good candidate for franchising.

#### THE PROCESS OF FRANCHISING

When a company makes a decision to franchise, it must first develop a sound plan for expansion. The plan must take into consideration the numerous issues confronting a new franchisor: speed of growth, territorial development, support services, staffing, and fee structure, to name several of the most important issues. Larger companies need to address more complex issues such as channel conflict, anti-trust, and resource allocation issues. And obviously, this entire plan needs to be subjected to rigorous financial analysis and scrutiny to fine-tune the strategy for growth.

Once this plan is in place, the franchisor needs the proper legal documentation. At a minimum, the franchisor will need a franchise contract, an offering circular (as required under FTC Rule 436), and, depending on where franchises are being sold, state registrations. There are literally hundreds of different business issues that must be addressed in a good franchise agreement, and the decisions made regarding these issues will ultimately dictate the franchisor's success.

Quality control for a new franchisor involves the development of highly developed systems. Generally, this translates into the development of an operations manual. This manual must contain not only the systems used by the business, but also the checklists, policies, procedures, and tactics that will allow these systems to be uniformly enforced. Moreover, operations manuals must be careful to avoid the creation of an agency and must also address issues that could create claims of negligence if the franchisor is to maintain an effective shield from consumer liability.

Finally, the new franchisor must develop the ability to market and sell franchises. That requires knowledge of how to attract the prospective buyer and the necessary materials (brochures, mini-brochures, videotapes, DVDs, etc.) that will help make the sale. Moreover, since the franchise sales process is highly regulated, the franchisor needs to be educated in proper sales, disclosure, and compliance techniques.

Every new franchisor quickly learns that when they turned to franchising they entered a completely different business. Regardless of how the franchisee makes money, the franchisor has two roles: selling franchises and servicing franchisees. And of the two, ensuring the success of the franchisee is the most important.

Properly structured, franchising can allow small companies to more effectively compete with much larger competitors. It can also allow large companies to gain the advantages of highly motivated unit management while reducing overhead. As such, franchising is an option that more and more companies should explore.

The key to success in franchising is successful franchisees. Without successful franchisees, no franchise system will last. But if you can put the interests of your franchisee first, those same franchisees might help you become the next McDonald's.

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