

Addison Aaron

Franchising – the pathway to wealth creation

-Reyhaneh Olyie

Franchising Globally

at an accelerated pace, far faster than the franchisor could

Developing a business using the franchising model has been a major feature of retailing in the USA for many years. In this country it is more associated with US based fast food outlets such as McDonalds and KFC although recently the UK has seen an explosion in both the number and type of franchises available. In fact there seems little limit on what sort of business can be franchised from oven cleaning at domestic premises to specialist repairs servicing the garage trade.

Franchising works because no-one works harder for anyone than for himself. Franchising incentivises the local management or operator as his income depends on performance.

In businesses where there are problems with staff theft, franchising provides the local management with an incentive to keep on top of the problem as the loss falls directly on the franchisee and not the central organization.

The proof of the pudding is always in the eating. Have you noticed how fast and aggressively mini-cabs are driven from one dare to the other? The driver gets paid per fare the more fares he carries the more money he earns. Likewise the franchisee will maximize turnover and minimize shrinkage to ensure he receives maximum personal returns on his investment. Little wonder franchising has been so popular in the USA.

Franchising works well for the franchisor (the business that owns the franchise rights) as it is able to develop its business using other people's money without taking on any liability and thus obtain massive returns on investment. It allows the franchisor to build its business

hope to achieve by more traditional business methods. Getting its chain across the country helps eliminate potential competitors maximizing the long term returns too.

Further, now that the labour market is highly regulated, it insulates the franchisor from that labour risk associated with employing people in local branches too! The franchisor need only concern itself with its central organization; each franchisee (the local operator) takes on all the regulatory risk including the labour risk himself. Of course, a good franchisor will be able to provide guidance and support where necessary but that can be subcontracted out to an appropriate professional firm as and when required.

The franchisor usually receives an upfront fee from the franchisee when he takes on the franchise. Generally this fee should only reflect the costs of setting up the franchise including training. Some of the more established franchisors initial fees do include some contribution towards paying for goodwill. The bulk of the profits come from the ongoing management fee which is usually based on turnover. In a fast food outlet this can vary between 3% and 12% of turnover. Even at 3% the rewards for the franchisor can be very significant. A reasonably successful fast food outlet or sandwich shop should turnover around £250,000 per annum (excluding VAT). At 3% the management fee would be £7,500 per annum multiply that by 250 shops and the gross fee is nearly £1.9 million. At say 5% (the percentage used by some of the market leaders) comparative figures would be £12,500 and over £3 million. Those fees are gained by getting others to pay to

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open store on the franchisors behalf, that's good business. Franchisors can also make additional profits by selling products into the franchise chain. For example in fast food there will be branded packaging not to mention manufactured food items for example pies.

The franchise system works well for the franchisee too. He gets expert help in setting up his business including a proven business model, training and the benefit of the experience of a successful entrepreneur in that business. It is little wonder that franchises are far less likely to fail than other businesses. This makes it easier for a franchisee to raise capital to support his business than if he had gone it alone, it also makes him much more financially secure from the start. A good franchise system is a win win for both parties.

Is my business suitable for franchising?

Franchising a business can be a great opportunity but is the business suitable? Take a quick look at any franchise magazine and you will see that almost any type of business can be franchised. However, franchising works best for high margin businesses where the start-up costs are not too significant. Hence why franchising has had such success with fast food. However, the ideal franchise opportunity is one requiring only a small personal investment with the bulk of the start-up costs being met by asset finance and producing a realistic income of around £40,000 to £50,000 for the franchisee. The franchisor is selling its expertise and therefore crucial to the franchisee that the business must perform better than the market average for non-franchise businesses. For example, a typical fish and chip shop may turnover £160,000 per annum. A good chip chop will turnover £250,000 plus and the franchisee is paying a fee to ensure his business turnover is the good figure not the typical one.

From the above it stands to reason that the strongest propositions for franchising will be businesses that have already developed into small chains, say 3 or more outlets. The franchisor is then clearly in the position to prove it has a viable business model and the experience at transferring it to new sites. However a single site business can still franchise successfully, it just needs a little more to sell it to the potential franchisee. Therefore award winning businesses are clearly at an advantage.

Is my existing business safe if I franchise?

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Yes it is, at Addison Aaron we would always recommend that you set up a new business separate from your existing business to do the franchising. There are lots of advantages to doing this, more than just protecting your existing business assets, for example using a new company may allow some inheritance tax planning.

Frequently we are asked about protecting the reputation that the franchisor has worked hard to build up. The franchise agreement should provide measurable quality standards for the franchisee to maintain with the provision that the franchise agreement can be terminated should the franchisee fail to work to the franchise standard. You remain in control of your reputation

Is it a good time to franchise my business?

Absolutely, many quality people are or have been redundant or are looking for a new career path or envisage a different way of life. The over forties traditionally struggle to find fresh employment and many of them will have received substantial severance packages. Without the prospects of getting back into work, taking on a franchise looks like a very attractive option. We even know of professionals who took on a sandwich franchise. Now is very definitely the right time to franchise a business as the economy is growing so are people's ambitions to explore new opportunities.

If you are interested in getting our advice on franchising please call the office to book your appointment.

About the author:

Reyhaneh Olyie joined Addison Aaron 3 years ago and is currently working on our international operations in the middle-east.



About the Firm

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