

is
franchising

for you?



EXPLORING YOUR
BUSINESS EXPANSION
OPTIONS

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Growing Your Business – What Are Your Options?

So, you've reached a point in your business where you want more; you want your business to expand and to bring more possibilities. Now what? What are your options? Franchising probably comes to mind as one of them, but you may be asking yourself: what is franchising, really? and do I have any other alternatives? In this short book our objective is to help you answer these two questions.

There are three main options available to businesses seeking to expand. These are:

- Opening company owned and operated outlets,
- Creating partnerships or joint ventures; and,
- Forming contractual relationships with independent third parties through "Business Opportunities".

Company-Owned Locations

Your first option for expansion is to keep it all under your total control by opening additional company-owned locations. This is obviously a costly option as you will have to invest your own financial resources to open each new location and you will have to hire staff to run them. This larger investment can consume your profits for a long time or you may have to incur significant debt and your profits will have to go to pay it back. For many people opening company-owned locations means a slower growth. However, having company owned locations means you do not have to share the profits generated by them with anyone else other than your creditors; you also will have total managerial control over the new locations. Therefore, this method of expansion can be the best option for you depending on your objectives.

Company-Owned Locations Pros:

- It provides you with total control over the operations and decisions making in these new locations.
- You keep all the profits from all the locations.

Company-Owned Locations Cons:

- All the money has to come from you or creditors.
- It requires hiring and managing more staff to operate the locations.
- Depending on your access to money, it can slow your growth.

Consider growing your business with company-owned locations when you have unlimited resources available to you and when you desire total control over the operations.

Partnerships and Joint Ventures

If you do not want to go it alone, you may be able to find others to share in the investment and in the rewards of expanding your business. You can bring investors into the picture by entering into partnerships or joint ventures; however by doing so you'll have to surrender some equity and thus you lose some level of control. Partnerships and Joint Ventures also mean that you will have to share the profits from the new locations; but, your own investment requirements will not be as large. Bringing partners or going into joint ventures can provide the capital needed for quicker expansion. The obvious problem with partnerships is potential personal or managerial style conflicts with partners which often times lead to costly dissolutions of this type of relationship.

Partnerships and Joint Ventures Pros:

- The money required to open new locations does not have to come all from you or from creditors.
- You share the managerial responsibilities of the new locations.

- You may be able to accelerate your growth as you will have access to other people's funds.
- The cost of setting up a partnership is minimal compared with other methods of expansion.

Partnerships and Joint Ventures Cons:

- You have to share the profits of the new locations.
- You lose some control.
- You may have conflicts with your partners that lead to costly separations.
- Expansion via partnerships is limited.

Consider growing your business with Partnerships and Joint Ventures when you find compatible people who share your vision, your objectives and your managerial style; and, when you desire a limited number of locations (less than 5 is a good rule of thumb).

Business Opportunities

Your third option is to form contractual relationships with independent third parties through "Business Opportunities". For most people this is the most desirable alternative for expansion since you do not have to share managerial control (of the parent company), grant equity, or go into debt to grow your business.

The term "Business Opportunities" simply refers to various business affiliations created by successful companies for distributing products and services. "Business Opportunities" include: *licensing, distributors, and dealerships as well as franchising.* Although not discussed in this book, other "Business Opportunities" include dealerships, agencies and multi-level marketing agreements. In today's regulatory environment franchising is by far the most popular and practical expansion method of all of these types of affiliations. However your objectives will determine the most appropriate way to grow your business.

Licensing

Licensing is the precursor to franchising, but as franchising has grown, licensing has been redefined and its scope has been reduced. Licensing agreements are simply the grant of rights to use a method or technology, equipment, products and services. In other words, through the use of licensing agreements, successful businesses give other businesses or individuals the right to use any or all of the following intellectual property, assets, or systems:

- Trade names, Trade dress, and Trademarks
- Specific manufacturing processes or technology,
- Technical procedures,
- Selling methods,
- Special equipment,
- Services, and/or
- Products.

A classic example of successful licensing occurs in the pharmaceutical business. Manufacturers of pharmaceuticals and/or owners of patents grant a license to companies or individuals to produce and sell its medicines and other pharmaceuticals within a given territory. These cases usually involve the granting of manufacturing processes and trade names and do not cover the operation of the entire business.

Some other examples of licensing include the mass licensing of software; the trademark or brand licensing such as in the case of Nike granting the rights to a store to use the name and carry its products; the license of artwork such as Kinkaid artworks, the license of characters or celebrities such as Disney characters or sports celebrities.

In some cases, the granting business or licensor teaches its licensees to use its methods, and follow established technical procedures. It may make available the necessary equipment and supplies for establishing and

operating the licensed business. In some cases it may even involve the granting access to use trade names and trademarks. But licensing does not include a complete business format. That is, a licensing company can dictate the way a product is manufactured or sold or the way a service delivered, but it does not get involved in the way the entire business operates.

In the U.S. today very few businesses can be expanded via licensing. The above examples are some of the exceptions. Further, two key considerations in deciding if a business should license are whether the license is to be granted to people who already have a business; and the level of income the licensed business will generate.

Licensing Pros:

- Creating a license is less expensive than franchising.
- You can enter into new markets with others that are managerially qualified to produce, market, and distribute your products.

Licensing Cons:

- State regulatory bodies now view what used to be ideal licensing opportunities as franchises.
- The licensee retains most of the profits, not the company granting the license.

Consider growing your business through Licensing when you have a patented process, service or product and you want to offer it to other businesses as an add on to what they already offer. Be aware that you will need to comply with the business opportunities laws of each state you enter.

Distributorships and Dealerships

Simply stated, distributors and dealers sell and service a company's products. The main difference between them is that distributors are normally wholesalers. This means they can sell to other distributors. Dealers, on the other hand, are limited to selling to retail customers. Occasionally, distributors sell directly to the retail customers, but dealers never sell to other distributors or dealers. Distributors and dealers lower their risk by associating with known products and services. Yet since they receive no other support except product knowledge, they face a higher risk than do participants in other business opportunities.

Distributorships and Dealerships Pros:

- You need less capital to grow since investors provide the financial funds for expanding into new territories.
- Investors are generally more motivated to succeed than are employees.
- There is limited risk to your company should a distributor or dealership fail.
- You do not have to provide dealer or distributor support beyond providing sales and marketing training.

Distributorships and Dealerships Cons:

- You have little, if any, influence on whether distributors or dealers devote their full energies to promoting your products.
- Dealers and distributors may hurt your company's reputation and brand.
- Dealers and distributors may carry and promote the products of competing companies.

Consider growing your business through Distributors and Dealers when you have a service or product you want to get to consumers and you do not mind having people dedicating only a portion of their energy to what your offering. Be aware that you will need to comply with the business opportunities laws of each state you enter.

Franchising

Franchising allows you to expand your business by entering into relationships with other independent business owners through franchise agreements. In these types of agreements you are called the *franchisor* and the other independent business owner is called the *franchisee*. You, as the franchisor, grant the use of your trademarks, trade names, and other intellectual property to your franchisees. You also teach them how to successfully open and operate one of your locations. In return, franchisees pay you an upfront fee called the initial franchise fee; and, they also make monthly or other regular payments to you for as long as they are associated with you via the franchise agreement.

The Federal Trade Commission and state regulatory agencies have developed a formal set of rules and regulations that they call disclosure requirements. They also regulate the relationship between franchisors and their franchisees. Additionally, the Federal Trade Commission has created criteria to determine whether or not a business meets the definition of a franchise under their Franchise Rule. They basically look at the three factors we mentioned before to know if your business is or will be deemed a franchise ask yourself the following questions:

I. Trademark

Do you want to grant the right to others to distribute goods and services bearing your trademark, service mark, trade name, advertising, or other commercial symbol? In other words, do you want the new locations to use your business name and display your logo? Are you okay with the locations not trading under your name yet offering your products and services?

2. Significant control or assistance

Do you want to have significant control over the way others operate their businesses? For example, do you want to approve the site, the design and the appearance of each location? Do you want to dictate the operating hours, the accounting practices as well as other business practices? Do you want to ensure that all locations follow and use the same promotional campaigns? Or, are you okay with every location doing their own thing, choosing whatever they want to look like, serving customers whenever and however they chose?

OR

Do you want to provide assistance to the owners of the new locations? For example, do you want to provide training programs that will teach others how to obtain and serve clients? Do you want to provide operations manuals detailing how others should operate their businesses? Or, are you okay with them figuring out how to run the business as they go?

3. Required Payment

Do you want others to pay you an upfront fee larger than \$500 to access your knowledge and open a location? Do you want others to pay you ongoing fees as royalties, training fees, bookkeeping charges or other payments for services, rent, or even from product sales?

If you are considering entering into a business relationship which involves **ALL** three of these elements, you are contemplating a franchise. You can call it what you want but by the Franchise Rule as specified by the Federal Trade Commission will deem your business a franchise. And, as a franchise you are required to provide a disclosure document to those people who wish to enter into a business relationship with you (prospective franchisees). If you fail to provide such a document, you are subject to fines up to \$10,000 per violation at the federal level. What's worse, in some states, violation of franchise laws is considered a felony.

Why is franchising so popular?

Franchising is popular for several reasons. Of all the alternatives for successful business expansion franchising goes beyond the contractual agreement to strongly incorporate business and human considerations. The franchisor is the creator of the business concept with the desire to expand, while the franchisee is the ‘partner’ who seeks training and support beyond product knowledge to successfully operate a business. Typically franchisees have never owned a business before and they want and/or need to be trained on how to operate the entire business effectively. Furthermore, franchisees normally want to focus on the daily operations of the business without having to worry about product and/or service research and development. These considerations make for a unique relationship where franchisees are “*in business for themselves but not by themselves;*” and where they take care of today while franchisors take care of tomorrow.

The unique franchise relationship requires that you enter a completely new business so it is a great alternative if you are somewhat tired of doing the same thing but love your business. Whether your business is bakery, a consulting practice, a sandwich shop or a home improvement service, as a franchisor you are now in the business of recruiting, training and supporting franchisees. Your responsibilities shift from the daily operations of your location to the protection and promotion of your brand name and your intellectual property not only for your own future benefit, but also for the sake of all your franchisees. You can now share your passion about your business with others and help them see what you first saw. Additionally your job now includes planning and preparing for the future, staying ahead of the competition, as well as researching and creating new products and services to protect the position of your business in the market. In other words, your mission now incorporates ensuring a prosperous future for your franchisees and your brand not just your own locations.

In exchange for the rights and continuing support you will provide to your franchisees, they will normally pay initial fees and also agree to pay ongoing monthly royalty fees, sometimes called management fees as well as other fees for services you may provide them. There are also several other

sources of revenue and benefits for a franchisor. In some instances, you are able to negotiate discounts or rebates from suppliers for the purchases of product by franchisees. These discounts and rebates can be shared with your franchisees. Further if you manufacture and sell products to your franchisees, you will benefit from your mark-up. Additionally, it is quite common for franchisees to be required to contribute monthly to national advertising funds to build and promote your brand that benefits everyone.

It is important to understand that when people buy a franchise, they are not purchasing a business; rather, they are simply acquiring the rights to benefit from someone else's efforts. In other words, you have invested resources to build a successful business, which, in turn, you will "license" to franchisees under a franchise agreement. Your proven business provides opportunities for individuals seeking alternatives to traditional employment without having to assume all of the risks associated with self-employment and start ups. Franchisees receive the right to participate in your success without having to venture alone into an unknown area of business risk.

Remember, in distinguishing between a franchise and all other "business opportunities," there are three distinct elements that set franchising apart from other methods of doing business. It is all of these three elements that have made franchising so popular. But all three elements must be present in order for a franchise to exist:

- The rights to use the company's registered trademarks and logos must be granted;
- Significant control over operations OR assistance and training must be provided to franchisees; and,
- Payments of an initial franchise fee as well as continuing payments (i.e. Royalty or Management Services) fees.

When comparing franchising to other expansion methods, what sets it apart is the inclusion of a "Business Format System." The Business Format System provides franchisees with the "how to" for starting and operating the franchised business. It provides the franchisor with control over how

franchisees deliver services, sell products, and how it conducts business on a daily basis. This system normally includes Operation Manuals, Training and Procedures Guides, and often the accounting systems to record and monitor the performance of the business. The Business Format System, when documented in Operations and Procedures Manuals, becomes an extension of the franchise agreement.

Franchising Pros:

- Someone else (i.e., the franchisee) provides the capital for each new location opened.
- Franchisees have an economic as well as a personal interest in ensuring that the new location succeeds.
- Because of their personal financial investment franchisees will typically be more motivated to manage the franchise than company employees.
- Your company can grow more quickly by opening franchises than by opening company-owned outlets because capital will not be an issue.
- Franchising allows you to grow without sacrificing control over business operations.
- You, as the franchisor, can continually change the business format to meet changing customer requirements.
- You have total control over how franchisees operate the business. If they do not follow your system, they are in breach of the agreement and you can terminate your relationship with them.
- Franchises are commonly accepted and sought after by lessors.
- The successes of one location spill over to the franchise network.
- Lending institutions are more agreeable to consider a loan to an individual who is investing in a franchise than they would if the same person was opening an independent business.
- Franchises are exempt from “Business Opportunities” state laws.

- Businesses that are franchised tend to grow stronger brand recognition than most independent businesses.

Franchising Cons:

- Franchise systems are expensive to create and to maintain.
- Although franchises are exempt from “Business Opportunities” state laws, they have special disclosure requirements at the Federal and state levels.
- The failures of one location can spill over to the rest of the franchise network.
- You, as the franchisor, forego profits at the franchisee level; profits from the franchised business remain mostly with the franchisee.
- You will have to listen to the opinions of your franchisees more than you normally would do with employees.
- You must ensure that your franchisees are fully and continually trained on how to operate their business and this requires resources and time.
- You start a new and different business when you franchise. You now are in the franchising business which is all about recruiting, training and supporting franchisees. You, thus, must be able, capable and willing to learn the new business and let go of the past responsibilities.
- A franchise organization requires staff to assist, train and support franchisees on an ongoing basis.
- Your responsibility is magnified with the addition of every franchisee. You now must focus on innovation and the protection of your intellectual property not only for your own sake but for the sake of each franchisee and their families.

Consider growing your business through franchising if:

- **You want all your locations to operate under your trade name and display your logo;**
- **You desire control over the operations of the business and how the products and services are delivered to customer and to ensure others do it right you will provide training and support; and**
- **You want to be remunerated for your efforts initially and on a continuing basis.**

Want to know more? Wondering how all of this applies to your business? Let us answer your questions. Give us a call 828-505-0908 for a No Cost, No Obligation Consultation.