

# Business expansion: an overview of franchising

## How does Franchising work?

1. The franchisor develops a successful business which it would like to expand.
2. The business is distinguished by:
  - (i) A particular way or method of doing things, which can be replicated; and
  - (ii) A trading style (usually consisting of a name associated with the franchisor, together with trade marks, colours etc) which together make up the business' "brand".
3. The franchisor can then allow another person (the franchisee) to operate the business under the same brand (using the same name, trade marks, colours etc) and following the same system. If the replicated business is carried out in the same way under the same brand the result should be, from the end consumer's point of view, the same experience.
4. Usually the franchisor will allow a particular franchisee to operate the franchised business as an independent operator in a particular location or territory only, and for a specified period, usually five or ten years with rights of renewal.
5. The franchisor provides the franchisee with training and assistance in operating the business in the correct way, and exercises continued control over the franchisee to ensure that standards of quality are maintained.
6. The franchisee pays an initial fee for the franchise and then usually a continuing royalty or management service fee to the franchisor. This is often a percentage of the franchisee's gross turnover.
7. Hopefully, the end result will be a franchised network that produces a consistent experience for the consumer under a recognised brand and which can become more than the sum of its individual parts - a national brand associated with high quality products/services.

## What are the advantages and disadvantages?

The advantages of franchising for the franchisor (as against simply building up its business itself) are that:

- i. The franchisor can expand its brand nationally and receive a financial return from the success of that brand from its franchisees for a fraction of the investment (in both time and money) that the franchisor would have required were it to attempt to expand using its own resources;
- ii. The individual franchisees - who each own their own franchise - are in business on their own account and should therefore be more motivated than an employee might be meaning that each individual franchise may be more successful than it would be were it operated by an employee who has no ultimate stake in the success or failure of the business;
- iii. If a franchisee's business were to fail, as that business is separate from the franchisor, the franchisor does not suffer any direct financial loss (though the brand could be damaged by too many failures!).

The disadvantages of franchising for the franchisor (as against simply building its business itself) are that:

- i. the franchise network will need managing and requires time and resources to do that; and
- ii. there is a risk that an element of control over each individual franchise may be lost; and
- iii. there is a risk that inconsistent quality between franchisees could damage the brand.

What points are important?

It is crucial to ensure that the franchise is built around:

- i. a distinctive brand consisting of trade marks and other “intellectual property” legally owned, and controlled by, the franchisor;
- ii. a clear method and system for the operation of the franchised business together with a distinct or unique offering (ie what is it that the franchisee can offer to customers as part of a franchise network over and above what can be offered if trading outside of the network?);
- iii. a strong legally binding franchise agreement which, whilst incorporating necessary protection for the franchisee, gives the franchisor the power to “call the shots”, controlling and developing the franchise network, ensuring consistent quality and even, if necessary, expelling under-performing franchisees;
- iv. a comprehensive Operations Manual (which is the franchise “bible”, setting out details of the system by which the business is to be conducted);
- v. an infrastructure for the provision of training and support (both initially and ongoing); and
- vi. strong relationships with key suppliers to the franchise network

How does one go about it?

The franchisor should have run a ‘pilot operation’ in order to test the business for its suitability to franchising. The pilot operation should usually be run for at least a year, preferably two. This will enable a financial track record to be established (the franchisees will want to see a track record of success before parting with their hard earned cash by way of a franchisee fee! The banks will want to see it before they lend money to the franchisees). The pilot operation will also enable the franchisor to establish and refine the “system” or method of doing business which will be critical to the success of the franchise, and which will need to be accurately replicated by the franchisee.

Usually the prospective franchisor will engage a franchise consultant and a franchise solicitor to assist in putting together the procedural and legal documentation that will be required. The consultant will help get the business into a shape that can be successfully franchised, and assist in producing the Operations Manual. The solicitor will need to ensure that financial information, prospectus, disclosure documents, trade marks and other elements of the brand are protected and owned by the franchisor and that the franchise agreement enables the franchisor to run the franchise network efficiently.

It is desirable for franchisors to apply for membership of the British Franchise Association (the industry trade association) as this will give the franchise credibility with prospective franchisees. The franchise consultant and solicitor will be able to help the prospective franchisor with the application.

We are happy to offer an initial “without obligation” meeting with all clients and prospective clients to discuss your plans for business expansion whether through Franchising or otherwise.

If you would like further information on Franchising, please contact our **Franchising team**.