

# Developing a Proper Franchise Program

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Franchising represents an attractive means for many manufacturers, retailers and service providers to expand their businesses. The principal reason many companies choose to franchise is that it allows for expansion without the amount of capital, funded by the franchisor, required under other forms of expansion. However, franchising is only one of many expansion alternatives businesses should consider.

Many of the advantages and disadvantages perceived in franchising are also found in other methods of distribution. While franchising can be an exceptional method of distribution, for some companies, other methods may be more suitable and advantageous.

Modern franchising is not the simplistic "sure fire", "rapid", "inexpensive" method of company expansion it is portrayed to be in some of the entrepreneurial media.

Conversely, it does not have high failure rates, overly burdensome regulations, excessive litigation or high start up costs, to the extent portrayed in other more main line business publications.

It is, a method of distribution embraced by thousands of companies in over 75 different industries. As such, it has had amazing successes, unfortunate failures, and its share of outright fraud since it was introduced into the United States after the Civil War.

Companies need to consider the advantages and disadvantages of franchising. These may include:

- ◆ control

- ◆ motivation
- ◆ alternative growth capital sources
- ◆ contingent liability
- ◆ equity dilution
- ◆ market penetration
- ◆ trademark enhancement
- ◆ collective buying power
- ◆ local management
- ◆ sources of capital
- ◆ program development, maintenance and management costs
- ◆ independence and interdependence
- ◆ franchisee relations and franchise legal requirements .... among a host of others issues.

These must all be considered before a company commits to the development of a franchise program.

Even after considering these issues, there is a need to examine whether a business is ready to franchise. This test of "franchisability" includes a critical review of a company's:

- ◆ Industry segment
- ◆ Existing operating systems
- ◆ Marketability of the franchise offering
- ◆ Geographic strategy
- ◆ Ability to protect its trademark and Tradename
- ◆ The organization required to franchise
- ◆ Obligations of the franchisor and the franchisee
- ◆ Training requirements to transfer operational knowledge
- ◆ Role and size of field organization
- ◆ Alternative methods of expansion
- ◆ Prototype development issues

- ◆ Sources of franchisor revenue
- ◆ Franchise development costs (franchisor and franchisee)
- ◆ Financial projections and analysis (franchisor and franchisee)
- ◆ Sources and availability of capital

If, after completing the feasibility analysis, the results are positive (that is, franchising, on balance, appears to be the best alternative for the company), the next step is to plan the **development of the franchise system.**

It is important to understand that it is the *system* which will be offered and the *system* which will guide both the franchisor and franchisee to success. Many of the franchise packagers (both legal and consulting) advertising in the entrepreneurial publications paint franchise development as mainly a legal and marketing process.

The legal documents and marketing materials, while *required* and *necessary* to sell franchises, are not *sufficient* to operate a successful franchise program

The builder of a franchise program needs to follow a detailed business blueprint. This business blueprint, often referred to as a business or strategic plan, examines the issues and makes the determinations needed to implement the franchising strategy.

While each company differs, areas to consider in a franchise strategic plan include:

- ◆ Accounting/control/reporting systems
- ◆ Advertising/publicity/promotion
- ◆ Capital requirements
- ◆ Communication
- ◆ Cooperatives and buying groups

- ◆ Conversion strategy
- ◆ Development of internal structural elements - implementation
- ◆ Dispute resolution and dispute prevention
- ◆ Franchisor field services
- ◆ Financial planning and analysis
- ◆ Franchisee operations
- ◆ Franchisee recruitment and relations
- ◆ Franchisee staffing and training
- ◆ Franchisor organization and training
- ◆ International
- ◆ Insurance
- ◆ Investment hurdles
- ◆ Legal documentation and agreements
- ◆ Location –
  - ◆ selection
  - ◆ acquisition
  - ◆ management
- ◆ Location construction
- ◆ Market research
- ◆ Market strategy
- ◆ Merchandising
- ◆ Management Information Systems and Point Of Sale Systems
- ◆ Monitoring mechanisms
- ◆ Ongoing services
- ◆ Packaging/labeling
- ◆ Policy formation

The franchise system ultimately developed and the franchisor/franchisee relationship established are shaped by determinations made in the strategic plan. Planning, policies, procedures, ongoing administrative monitoring and support services are decided upon in the strategic plan.

It gives the franchisor a basis to begin the development of the components of the program. These include: the operations manuals and training programs, operating systems, marketing programs for both franchisees and retail customers, development of the fee structure and development of the required documentation by specialized franchise legal counsel.

The final product of the initial strategic development should be the legal documentation of the franchise system. This should be based on the determinations made in all other areas of the plan. The legal documentation spells out the relationship between the parties and describes the system. The disclosure document provides prospective franchisees with at least the minimum information required by law and professional practices, while the legal agreement incorporates these disclosures into the contract between the parties.

While minimum disclosure standards are specified, some of the issues addressed include:

- ◆ initial and ongoing fees
- ◆ franchise terms
- ◆ renewal policies
- ◆ termination rights
- ◆ transfer rights
- ◆ assignment rights
- ◆ territorial exclusivity
- ◆ protection of trademarks, service marks and trade secrets
- ◆ lease/sublease policies
- ◆ site selection and criteria
- ◆ franchisee's reporting and audit responsibilities
- ◆ purchasing requirements
- ◆ retail performance

◆ marketing and advertising ..... among others.

Since the laws and practices governing franchising is evolving constantly, the use of specialized legal counsel with current experience is essential. Franchise legal documentation is not the place to trust well intentioned general practitioners.

Finally, an Action Plan should be developed which will organize and schedule the tasks to be completed in implementing the plan. It should provide for controls and feedback to ensure a clear direction for the company.

Control over the timing of the plan's implementation is critical. The Action Plan ensures that something is going to happen.

Many business plans end without an effective implementation strategy. This is one of the major causes of strategic drift. Without a clear implementation plan, the business planning process is fairly useless as a management tool.

A criticism of a planned strategic development is that it is time-consuming and costly. It may limit a company's ability to franchise because the required professional fees limit the capital available to initially operate the system. Nothing could be further from the fact.

As the resources required are detailed in the feasibility assessment, before the majority of the professional fees and other costs are expended, the process protects the franchisor and their future franchisees from being undercapitalized.

The reason start up franchisees have a higher success rate than independent start up companies has little to do with the quality of their product or services, the ambition and hard work of the owners, or their available capital. The reason is that franchisees are better prepared to begin and to operate their businesses when the franchisor has followed the procedures outlined here.

The strategic development is the first step in providing those future franchisees with the tools they will require to succeed.