

Franchising

A Vehicle for Economic Empowerment

By Silvan Pillay

What Is Franchising?

The simplest definition for franchising is: "A method of doing business whereby a franchisor licenses trademarks, systems and methods of doing business to a franchisee in exchange for a recurring ongoing consideration i.e. a royalty fee or a franchise management fee".

Franchising is a form of a business by which the owner (franchisor) of a product, service, or method obtains distribution through affiliated dealers (franchisees). A franchisor is expected to offer assistance in organising, training, merchandising, marketing, and giving direction in return for a consideration.

Franchising usually involves a contractual arrangement between a franchisor (a manufacturer, a wholesaler, or a service sponsor) and a retail franchisee, which allows the franchisee to conduct a given form of business under an established name and according to a given pattern of business.



Silvan Pillay
CEO: africabrokers.comTM
*Franchising Is A Key Vehicle For
Economic Empowerment.*

Does Franchising Imply That You Are Self-employed?

In some respects, NO. You still have to answer to someone else and follow his or her direction. You don't really own the business; you own the assets you've purchased in order to establish the business. If you consider that you are in business for yourself, but not by yourself, then YES...you are self employed.

Franchising Is the Fastest Growing Business Economic Model

Globally, franchising is the most popular and the fastest growing business economic model. It assembles business relationships that allow people to share brand identification, a proven method of doing business and a successful marketing and distribution system. When most people think of a franchise, they think fast food. Franchising, however, long ago grew beyond the burger and fried-chicken shops. Today franchise concepts span over 70 different product and service sectors, including such businesses as auto-repair shops, children's art centers, fitness clubs, law & consulting practices, and many home based businesses. The franchising business model has turned into a major economic engine globally and it is one that's providing increasing opportunities for companies and individual entrepreneurs alike.

For South Africa, and for Africa as whole, **franchising is a perfect vehicle for the economic empowerment of the historically disadvantaged sectors of the population.** This brings with it the need for the establishment of more franchises. That is, franchising businesses that are established, that has a unique offering and where the method of doing business has been tried, tested and perfected. Apart from empowering companies and individuals, there should be a particular focus on *identifying labour intensive businesses that have the potential to make a significant and positive impact on employment creation* as well as those businesses that have a **product or service offering for export markets** with the ultimate objective of booming local economies.

The Advantages of Franchising

1. An investment is usually made into a proven business.
2. A faster start up, developing a customer base quicker, and experiencing profitability quicker are key attractions.
3. There is a known quantifiable proven formula.
4. Owner transition and training is available, and there is full control of strategic direction and ability to thoroughly review past records and company history.
5. The biggest advantage of franchising appears to be the reduction of risk you will be taking for your investment.
6. You also usually get better deals on supplies because the franchise company can purchase goods and supplies in bulk for the entire chain, and then pass that savings on to you and the other franchise units.
7. Customers are dealing with a "known" rather than an "unknown."

The Disadvantages of Franchising

1. Some franchises can be very expensive. Franchisors expect you to follow their operations manuals to the letter. No flexibility on your part.
2. Buying a franchise is like marrying someone you haven't known for long.
3. The relative security offered by franchisors may be exaggerated. Some franchisors are in for a quick buck.
4. Franchising as a pyramid scheme. Some companies try to make money by just collecting franchise fees, and won't spend the time or money necessary to help their existing franchisees succeed.
5. Overcharging for supplies. Some franchisors may require you to buy supplies exclusively from them at inflated prices.
6. Fees for unnecessary training.
7. Misleading sales presentations. Some franchisors over-promise the moon in their pitches to prospective franchisees

Business Owners: Is Your Business Franchise Ready?

An appropriate first step in the decision to franchise is an examination of the question of whether or not a business concept is actually "franchisable." Any organization seriously considering franchising should undertake this analysis before implementing a franchise strategy. While it is impossible to determine the franchisability of a business concept without a significant amount of analysis, most franchise experts are guided by the following criteria to assess the readiness of a company for franchising and the likelihood that it will achieve success as a franchisor.

1. **Credibility:** To sell franchises, a company must first be credible in the eyes of its prospective franchisees. Large organisation size, number of outlets, years in operation, strength of management are key credibility factors.
2. **Differentiation:** In addition to credibility, a franchise organisation must be adequately differentiated from its franchised competitors. This can come in the form of a differentiated product or service, a reduced investment cost, a unique marketing strategy, or different target markets.
3. **Transferability of knowledge:** The next criterion is the ability to teach a system to others. To franchise, a business must generally be able to thoroughly educate a prospective franchisee in a relatively short period of time.
4. **Adaptability:** Next, measure how well a concept can be adapted from one market to the next. Some concepts do not adapt well over large geographic areas because of regional variations in consumer tastes or preferences.
5. **Refined and successful prototype operations:** A refined prototype is necessary to demonstrate that the system is proven, and is generally instrumental in the training of franchisees. The prototype also acts as a testing ground for new products, new services, marketing techniques, merchandising, and operational efficiencies.
6. **Documented systems:** All successful businesses have systems. But in order to be franchisable, these systems must be documented in a manner that communicates them effectively to franchisees.
7. **Affordability:** Affordability merely reflects a prospective franchisee's ability to pay for the franchise in question. This criterion is as much a reflection of the prospective franchisee as it is of the actual cost of opening a franchise.
8. **Return on Investment:** This is the real acid test. A franchised business must, of course, be profitable. But more than that, a franchised business must allow enough profit after a royalty for the franchisees to earn an adequate return on their investment of time and money.
9. **Market trends and conditions:** While not an indicator of franchisability as much as general indicators of the success of any business; these trends are key to long-term planning. Is the market growing or consolidating? How will that affect your business in the future? What impact will the Internet have? Will the franchisee's products and services remain relevant in the years ahead? What are other franchised and non-franchised competitors doing? And how will the competitive environment affect your franchisee's likelihood of long-term success.
10. **Capital:** While franchising is a low-cost means of expanding a business, it is not a "no cost" means of expansion. A franchisor needs the capital and resources to implement a franchise program. The resources required to initially implement a franchise program will vary depending on the scope of the expansion plan. If a company is looking to sell one or two franchised units, the necessary legal documentation may be completed at low costs. For franchisors targeting aggressive expansion, however, start-up costs can run into Hundreds of Thousands and more.
11. **Commitment to relationships:** Successful franchisors focus on building long-term relationships with their franchisees that are mutually rewarding. Unfortunately, not all franchise organizations understand the link that exists between relationships and profits. Strong franchisee relationships enable the franchisor to sell franchises more effectively, introduce needed changes into the system more easily, and motivate franchisees and their managers to provide a consistent level of products and services to their customers.

12. **Strength of management:** Finally, the single most important aspect contributing to the success of any franchise program is the strength of its management. More often than not, new franchisors will try to take everything on themselves. In addition to absorbing several new jobs for which the franchisor has little to no time, the franchisor needs to exhibit expertise in fields in which he or she may have little or no experience: franchise marketing, lead handling, franchise sales, ad fund management, training, and multi-unit operations management.

Entrepreneurs: How to Select the Right Franchise

Buying a franchise can be a daunting task. With thousands of franchises in over 70 different industries available worldwide, finding the best franchise can be like finding a needle in a haystack. Moreover, the best franchise for your neighbour might be a disaster in the waiting for you. How do you invest in the right franchise?

1. **Why?:** First, you must ask yourself certain questions and be very objective. Why do you want to own a franchise? If it's to get rich or to get on easy street and not have to work, then franchising will probably not meet your expectations. If you are like many people who have the dream of owning your own business (but not being on your own), being your own boss and having control of your life, then franchising may be for you.
2. **Strengths:** Be realistic and fully understand your strengths and weaknesses. Invest your strengths into the right type of franchise. Don't explore every franchise opportunity. Select only those you believe co-incides with your strengths
3. **Research:** Compile a list of the franchises that interest you. Go through their websites and set up meetings with the franchise manager/director.
4. **Disclosure Document:** Study the franchise disclosure document or prospectus. Here you want to see strong financial history, experienced people in key positions, and a company that has been in business for 3 years or more, the longer the better, has a large number of outlets and has few closed or bought back.
5. **Franchise Agreement:** Closely examine the franchise agreement. This is the contract between you and the company. Franchise agreements are always biased in favor of the franchisor, that's just the way it is. This can be good and bad. The company can be unfair in it's dealings with you and the franchise agreement may allow this, on the other hand you should want a strong franchisor.
6. **References:** Call as many franchisees as possible. Call at least 10. Find out how they are doing. The key question is "Would you buy this franchise again?"
7. **Visits:** Visit personally as many operating units as possible. At least three. Often the owner or manager will be more forthcoming in person than over the phone.
8. **Verify Financial Information:** If everything still looks good, then contact the sales rep and get as much definitive sales information as possible. Most franchisors will not make earnings claims but they will provide information with which you may extrapolate gross sales.
9. **Advisors:** If everything still looks good then go for it. If you are unsure, speak to qualified advisors.

The Five Reasons Franchises Fail

Generally, on a global level, 30% of small independent businesses fail within the first year, with less than 20% going beyond year 5. Franchises, on the other hand, are significantly more successful. Less than 5% of franchises fail. The reason(s) for failure could be a number of factors, most of which could have been prevented by due diligence during the early phase. The following are the main reasons franchises fail:

1. **The Idea.** Whether you are franchising your own company or buying into a franchise system, how the concept is received by the community is critical. While burgers seem to have universal appeal, not all food chains meet with majority approval. Also, if your business model is complicated you are in for a struggle. You want to create an operational standard that can be taught to and replicated by any businessperson. A company may be successful when run by the entrepreneur who dreamed up the concept, however, if the business model or prototype is not easily duplicated the chances for success are not so optimistic.
2. **Bad Location.** Ask seasoned franchisees to name one of the most important keys to a successful franchise and undoubtedly they will say, "Location, location, location." Even with a well-branded name, if you are off the beaten path, inconveniently located or in an isolated area the opportunity to be as lucrative as possible diminishes.
3. **Poor Marketing/Advertising.** Many well-established and reputable franchisors have marketing and advertising funds into which franchisees contribute monetarily. Chains like McDonald's and Subway have national campaigns, while other types of franchises may advertise on a local level. Some franchise concepts require a lot of legwork on behalf of the franchisee. Depending on the business you chose, you may have to solicit your own clients, as in technical and computer support franchises. If you are considering a concept that requires outside sales skills and you lack them, you may want to rethink your choice.

4. **Competition.** There are approximately 160,000 franchises in operation in the US. That means a lot of competition. If your market already is saturated with a concept you may want to consider something that still is popular but not yet tapped out. Medical spas and restaurants offering healthy choices are gaining ground among the public but there is abundant room on the business owner side.
5. **Unrealistic Expectations.** New franchisees are notorious for having very high expectations for their businesses. It may take 2-3 years before you see a profit and if you don't plan for that you may sink before you have a chance to swim.

A word to the wise: If you don't like people you should not buy a franchise. If you want to make it you have to put in long hours and work with all kinds of personalities. It's an undeniable fact that some people are more difficult to interact with than others. As a business owner you need to be able to interact well with people from all walks of life. The ability to manage employees also is essential to the success of your business.

If you're considering franchising your business or interested in buying a reputable and profitable franchise operation, contact africabrokers.com. The largest and most professional business brokering firm in Southern Africa.



Head Office: Pretoria

Tel: 012 460 0760, Fax: 012 460 1742, Cell: 082 459 1396

Email: info@africabrokers.com

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www.africabrokers.com**