

Franchising Your Business

Business owners are increasingly choosing to expand by franchising, which opens up new ways of distributing their products and services. This Guide describes how a franchise works, runs through the pros and cons of franchising, and looks at what to consider when setting one up.

What Is Franchising?

In a typical franchise arrangement, a business owner with a proven business model grants a licence to a separate company or person to trade under their brand, usually selling the same or similar products or services. The licence will commonly be in a new town or part of the country. The classic example is McDonald's, which licences the well-known name and brand to restaurant owners. Petrol stations are also often run as franchises.

The owner of the business model is called the franchisor, and the person or company granted the licence is called the franchisee. The franchisor will usually provide the franchisee with a package comprising all the elements necessary to establish and run the new business, and often provides continual assistance. The franchisee will pay the franchisor an upfront fee or premium and a share of their profits.

Main elements of a franchise

A franchise will usually have the following key elements:

- The franchisor allows the franchisee to use a brand associated with the franchisor
- The franchisee operates their business in accordance with the franchisor's concept and under the franchisor's name or trade mark, so that to the outside world the franchisee is the franchisor
- The franchisor exercises continuing quality control over the franchisee and provides ongoing assistance
- The franchisee periodically makes payments to the franchisor.



Is A Franchise Right For Your Business?

Franchising has a number of pros and cons.

✓ Advantages

Franchising offers the opportunity to secure distribution for products or services faster than if the franchisor had to train up their own employees, and develop their own internal marketing, sales and distribution organisation. A franchisee will provide their own capital, and this often allows a network to expand more quickly than if the franchisor had to find the funds. Also, the larger network of a franchise may increase purchasing power and reduce overheads, and so increase profitability.

A franchise create additional revenue streams, while reducing their risk in promoting and selling the products or services in the geographical market the franchise covers. They will also retain full ownership of their brand.

Many companies involved in the supply of goods or services seek to motivate their employees by linking pay and bonuses to sales. Franchising takes this one step further by linking the franchisee's financial well-being to the success of the franchisor's business.

✗ Disadvantages

A franchise might involve a loss of control. A franchisor will inevitably have to divulge substantial know-how and information about their business. Franchisees are independent third parties seeking to maximise their own profits, which might be at the expense of the franchisor. Having said that, the franchise agreement will impose restrictions on franchisees, and restrict their ability to use information for their own purposes.

There are also other changes for franchisors. Part of their profit will go on supporting an additional entity in the distribution chain, the franchisee. Furthermore, being a franchisor is a different job from running the original business. The skills required to control franchisees and provide the support required are different from those involved in operating a business through employees.



Setting Up A Franchise

What's involved in franchising a business? You will have to ensure that your business brand is protected, and that you set up operating processes which deliver the brand's promise. You will also have to provide support and training that enables franchisees to grow. Franchisees will be separate from your own business, not part of it. Whether the franchisee is a sole trader or (more commonly) a company, they will be a separate legal entity, and not a branch office or subsidiary of your business.

The first step in setting up a franchise is often to run a pilot scheme to confirm that the business can operate successfully as a franchise. Then the franchisor will develop an Operations Manual which describes in detail how the franchisee should run the business. In discussions with potential franchisees they will need to sign a confidentiality agreement (NDA), and provide pre-contract disclosure of information about the business and likely revenue.



Pilot Operation

A franchisor will often develop their franchise business using a pilot operation. They will own it, but it will be operated as if it is a franchised outlet. The pilot will usually run for 1-2 years, and some franchisors will operate more than one.

The reason for running a pilot is to test the model, and so that the franchisor can provide a proven successful business to new franchisees. Without a successful pilot operation, a franchisor will in essence be using the experience of franchisees to develop their businesses. A pilot operation is intended to establish whether the business will be successful, and how it can be improved. It will identify problem areas, and identify the most suitable marketing methods, positioning of outlets, the most effective combination of layout, equipment and staff, and techniques for management, training, accounting, stock control, etc.



Operations Manual

One of the most important aspects of the pilot operation is the development of an Operations Manual. This document, with the franchise contract, regulates the terms on which a franchisee operates the franchise business.

The Operations Manual sets out the day-to-day operational instructions to the franchisee. It will include confidential material that constitutes the secrets of the franchise's success. Accordingly the franchise agreement should be treated as confidential, and potential franchisees should sign a confidentiality agreement before they are allowed to read it.



Pre-contract disclosure

Franchisees will usually want to carry out due diligence to investigate the success (or otherwise) of the franchise. It is in the franchisor's interests to make a formal pre-contract disclosure, to avoid a franchisee claiming afterwards that they misrepresented the profitability of the franchise. This would involve disclosing specified facts and information about the franchisor, the business, the level and nature of the investment required, the contract, the existing network, and so on.



Intellectual property

A franchisor will have built up a substantial amount of know-how and brand awareness, which they should take steps to protect. Accordingly franchisors will need to make sure they have relevant trade marks for brand names and images.

Franchisors will also need to take steps to protect their copyright in the Operations Manual and other documents, such as training and marketing materials, and databases.



Franchise agreement

Once the franchisee has agreed to take on a franchise, they sign a franchise agreement with the franchisor. This document gives the franchisee a right to use the franchisor's distinctive trading format and intellectual property in return for a royalties payment. It will often contain details of how much the franchisee should spend on marketing, products and advertising, etc or will provide that the franchisor will undertake all of this but at the franchisees expense.

The contract will often restrict the franchisee's right to sell on the franchise, and to operate in the same sector after the agreement ends.

How We Can Help

We prepare the legal documents required for a successful franchise, including the franchise agreement and confidentiality agreements (NDAs). We can also advise on the contents of the Operations Manual, and on pre-contract disclosure.

We also work with professional adviser partners to advise on the steps needed to protect brands and other intellectual property. This Guide is for reference purposes only, and does not provide advice for any particular set of circumstances.

For further information, and to discuss your situation with no obligation, please contact us:

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