

How to use the Franchise Advantage

What you should
know about starting a
franchise system


FRANCHIZE
CONSULTANTS

First published 1998

2nd Edition 2000

3rd Edition 2002

4th Edition 2006

5th Edition 2008

Specialists in Licence and Franchise Development
Provide personal service and expert guidance at all
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FRANCHISE SECTOR MANAGEMENT CONSULTANTS

Preface

This booklet was prepared by Franchise Consultants (NZ) Limited, Auckland, New Zealand.

It was written to give the busy executive a quick overview of franchising as a business system, of its options for many types of business and of some of the elements involved in setting up a business format franchise operation.

Businesses wishing to investigate adapting a franchise business format are advised to seek competent advice with an experienced person or organisation who can familiarise themselves with the prospective company's business operation before counselling.

What is Franchising?

There is more than one kind of franchising, but for the purposes of this booklet we will be discussing Business Format Franchising.

Business Format Franchising is a method of business expansion through which a business owner or entity allows someone to market products or services under their name and trademark and with strict adherence to a prescribed system.

In return the Franchisee, as the person or organisation is called, pays an initial fee and usually some form of ongoing contribution. The Franchisee also pays all of the costs of getting into his or her own business.

Business Format Franchising started to grow in the United States in the mid 1950s and has continued to expand since that time not only in the United States but throughout the world.

In 1863 the Singer Sewing Machine Company franchised the right for people to sell its sewing machines. Coca Cola sold its first franchise in 1899.

Next came the automobile and petroleum dealers who decided to use the distributorship method of franchising in about 1910. These types of franchises were known as Product or Trademark Franchises. Primarily they were product distribution arrangements.

The Business Format Franchise is the grant of the right by one person or business (Franchisor) to another (Franchisee) which entitles the Franchisee to use the Franchisor's business system, trade name or brand and to run their business with continuing assistance provided by the Franchisor.

A Business Format Franchise is made up of the following elements:

- ❖ The full business concept and format which includes the brand and all intellectual property.
- ❖ A process of induction and training in all aspects of the business according to the business format which is documented within the Operations Manual, or set of manuals.
- ❖ Ongoing assistance, monitoring and guidance provided by the Franchisor to the Franchisees.

Business Format Franchising can perhaps be best described by using McDonald's restaurants as an example.

What McDonald's did which was different from most other people in the mid 1950s was to measure and provide a system for every action they took in preparing meals for their customers. They then did the same for how they operated the actual business side of things.

These systems were gradually perfected and the McDonald's franchise was sold on the open market as a franchise system and not just a franchise name.

Over the years McDonald's have continued to develop their system and to monitor their systems to ensure that they are being properly adhered to by Franchisees. McDonald's gives continuing training and coaching to all their franchise operators.

Although fast food restaurants were the first to use Business Format Franchising many different industries have successfully used this format over the years since its inception in the mid 1950s.

The International Franchise Association categorises over 75 different industry and commercial types using Business Format Franchising.

Wishing to Expand?

- Does your business have potential to expand?
 - Can it be replicated in different locations?
 - Does your type of business have potential longevity or does it have a limited life cycle?
- Is it a fashion or a trend? •••• What are your strategic objectives for the business? •••• Do you have the financial and operational resources in your business to fulfil your objectives? •••• If you don't have the financial and operational resources are you able to get them? •••• What are your personal goals and do they coincide with your expansionary aims? Could they be made to?

Assuming that your company has the potential for establishing a number of outlets or branches throughout New Zealand and perhaps then expand internationally, what are your capabilities at the present time for achieving your goals?

The following list contains some of the considerations that you must take into account.

- ❖ What are your resources? Do you have sufficient funds that can be devoted to the expansion?
- ❖ Do you have enough money to finance the establishment of say 20 outlets? If not, where will you get it?
- ❖ How strong are your personnel resources? Do you have the right people to participate in your expansion? Can your people grow with the company?
- ❖ Can you find the right people to manage the new outlets and can you train and manage them?
- ❖ How much time do you have to establish these 20 outlets before a competitor moves into the picture?

Franchising is a method of expansion which doesn't need large numbers of employees or a large amount of capital, and expansion can be achieved relatively quickly.

 Resources  People  Pace

these are the primary elements
influencing expansionary success.

The traditional method of expansion for most retail businesses and many service businesses is by adding company owned operations. That means that the company pays for all the costs of expansion. The company also, however, retains all the profits or losses. Some companies are happy expanding this way because in many cases they can see no alternative.

Just think what the cost of adding a new outlet may be. Most companies cannot finance an outlet out of retained earnings, they need to borrow and borrow heavily if they wish to expand rapidly and establish a large number of outlets. Think of the cost of debt servicing. Will your balance sheet allow it?

Finding and keeping good managers is difficult. Maintaining a reasonable performance from branch managers is not easy and the further away from Head Office they are, the harder it is to achieve good results.

Alternative methods of expansion could be:

❖❖❖ Joint Venture

Joint ventures normally commit business partners financially and operationally, which is positive. However, joint ventures generally require a significant amount of capital input and sometimes the joint venture partner can try to exert their authority, leading to friction in the relationship.

❖❖❖ Dealerships

Dealerships are also a method of expanding your business, but this method has its problems too. Your business and its products or services may be competing in the dealer's outlet with other distribution agreements they may have. You may be competing with companies who have bigger advertising budgets, bigger discounts, better brand recognition, long credit allowance and a host of other incentives which ensure that they get more favoured treatment.

❖❖❖ Large Sales Forces

Some companies expand by building up huge armies of "sales reps" who travel throughout the country selling the products and services. All this again at great expense and most times with little efficiency. A sales force needs constant motivation which again takes considerable support in the form of back up staff at Head Office and large quantities of capital resources.

These are forms of company owned expansion methods - all of which will have some strong points, but which also have many disadvantages.

❖❖❖ Move quickly to Step 3 for the good news!

Could Your Business be Franchised?

… You can now see that there are many advantages of franchising a business - but how can you tell if your business has the potential to be successfully franchised?

There are some basic rules which are good indicators as to whether your business could be franchised.

… Has the market accepted your product? You don't have to offer a new product to be a successful marketer. In fact most franchise systems have been developed by companies that have been marketing their product or service for some time. Of course a new innovation or version of an established product or service can be franchised using the knowledge and results of the established product or service as a basis to work from.

- ❖ Is your business profitable? Or can it be made profitable? There must be a reasonable profit available from working your business. If there is not a good profit people will not buy one of your franchises. Indeed by structuring your business and franchise system well and by streamlining it efficiently through improved franchise type systems, you can usually enhance your profitability.
- ❖ You must be able to train or teach Franchisees the business in a relatively short time frame. First you must be able to teach your business to other people. Second you must be able to teach them the basics of operating the business in an acceptable time frame – that is, weeks rather than years.

Your franchise system will be at an advantage if your business can be systemised to a greater degree. The more well planned and efficient systems you have in place, or put in place when you are developing your franchise, the better off everyone will be. Good, easy to follow systems mean shorter training time required for a Franchisee to grasp the running of the business.

- ❖ Good systems mean easier operating of the business
- ❖ Good systems mean consistent performance is possible by all the Franchisees
- ❖ Good systems cut down the chances of error
- ❖ Good systems make it easier for the Franchisor to monitor the group's performance
- ❖ Good systems mean less repetitive communication
- ❖ Good systems lead to happier employees
- ❖ Good systems mean more profits.

- ❖ Can your type of business be transferred to another part of the country or even to other countries? Can it be made to work in other areas and not just in your local district?
- ❖ Is it affordable? Will a Franchisee be able to pay you a reasonable franchise premium, purchase all the necessary fixtures, fittings, equipment and stock and allocate sufficient working capital, provide the ongoing royalty to you, and still get a good return on their investment?
- ❖ It certainly helps considerably if your business has been in operation and trading long enough to project its future success.
- ❖ On the other hand, successful franchise systems have been devised from scratch with a pilot established and then followed by instigating a full scale franchise network. If you intend doing this you need to get experienced advice on how to set up a business with the intention of developing a franchise system right from the start.
- ❖ A classic opportunity to start a franchise network is in an industry or business type that consists of many small units operating in a market without any dominant chain or big player. A franchise operation starting up in such a fragmented market quickly gains many advantages and usually ends up dominating that market.

How to Get It All Together

You have read of the advantages of franchising and have an idea of whether your business is able to be franchised. Now you want to do it, how do you go about it?

The first thing you need to realise, whether you are an individual entrepreneur or a large corporate executive, is that planning, organisation and franchise experience are very important in developing your franchise system.

Even if your organisation has a wealth of resources in conventional business you would be well advised to seek experienced franchise assistance.

Strategic Planning

This is where it all starts. It is the Situation Analysis, Feasibility Study and Implementation Planning stage where the critical assessment and planning is done.

Strategic Planning involves a review of the existing business and its market, consideration of the basic structure of the franchise system, an evaluation of all structural options available and the definition of the relationship between the Franchisor and Franchisees. It results in a comprehensive blueprint of the franchise system which is to be established and a plan for the development and implementation of that franchise system.

This resulting Franchise Development Plan must take into consideration all aspects of the intended franchise system. It must work out the most appropriate franchise format for that particular business in all its detail. This includes financial modelling to establish that the numbers stack up in the most advantageous manner for all involved.

Included in the many elements considered are determining the sources of income (and there can be more than six sources for a franchise system), establishing the entry costs, the profile of the ideal Franchisee, the proposed territories, suitable recruitment procedures, personnel and administration management for the Franchisor, training and support systems, protection of intellectual property, corporate identification and marketing and many more.

System Development & Manuals

This involves documenting the franchise system and creating the package of documentation necessary to give affect to the blueprinted system.

The two most important documents are the Franchise Agreement and the Franchise Operations Manual.

The Agreement gives legal effect to the franchise relationship and governs the fundamentals, rights and obligations of the parties. The Operations Manual and accompanying manuals in the set provide a comprehensive statement of procedures covering the technical, operational and management aspects of the system. This includes detailed guidelines, procedures and standards for both Franchisees and members of their team.

The Franchise Agreement should be written by a specialist franchise lawyer who should be provided with a copy of the Franchise Development Plan along with a brief on all the elements to be included in the Franchise Agreement. Do not make the mistake of putting the cart before the horse and asking a lawyer to write the Franchise Agreement before you have written your Franchise Development Plan and know what your systems are. It could cost you (and your franchisees) dearly in the long run.

Marketing & Implementation of your Franchise System

You are now at the stage of preparing suitable marketing materials and disclosure information about your franchise business opportunity. The strategy to be employed for recruiting Franchisees is specified in the Franchise Development Plan.

Now comes finalisation of the geographical network plan, recruitment of suitable Franchisees, followed by the training and establishment of franchise owners.

This is the time for the Franchisor to make certain organisational changes to reorient the business to serving the needs of Franchisees. This can involve changes in job description and reorientation and organisation of management.

Ongoing Support

Continuing stewardship of the franchise network is one of the three key success elements in operating a successful franchise business. They are:

- | | |
|---------------------------|-------------------------------------|
| | 1. Correct franchise format |
| Franchise success formula | 2. Selecting the right franchisees |
| | 3. Proper ongoing support programme |

Under a Business Format Franchise the Franchisor assumes a continuing obligation to provide ongoing operational, technical, management and marketing support. Successful Franchisors recognise the necessity for continuing hands-on involvement in the maintenance of the system for the dual purpose of monitoring image and standards as well as providing ongoing support to Franchisees.

Can Consultants Help and Are They Worth Consulting?

The very fact that you are considering franchising is a testimonial to consulting. Franchising is one of the purest examples of the value of having a consultant as a guide.

The Franchisor who takes professional consultancy advice is often responsible for the high success ratio for those who choose to operate under a franchise versus becoming an independent business.

An experienced franchise consulting company will have substantial knowledge and experience that can be applied to your business, situation and objectives.

A consultant can also often review the organisation more objectively than can insiders. As an outsider they can see things you cannot, they can touch politically sensitive areas where insiders dare not tread. The consultant's experience of contacts with many other companies can be invaluable. Those experiences of successes are what you want and need.

In any relationship with a consultant, it is important that the consultant continue to function as an independent outsider rather than part of the management. A consultant's role is to advise, recommend and provide specialised knowledge.

A professional consultant avoids making decisions, he or she urges and persuades clients towards a sound course of action. It is up to the management to weigh the recommendations, modify them if necessary to fit particular circumstances, make the final decisions and assume responsibility for them. A good consultant will suggest that the client staff be trained properly to carry on certain activities.

This eliminates the needless expense of the consultant providing services that the client can and should perform without outside help. A reliable consultant does not indulge in 'make work' activities for their own benefit.

It is not possible to identify standard fee schedules governing the charges of consultants because of the variables in the extent of the consultant's education and experience, the variety of work he or she has been successfully engaged in and the quality and character of his or her specialisation. Good franchise consulting is not expensive. A fee may sound high or low it depends just where you stand. Just remember, "if you think education is expensive, try failure."

The role of the consultant is to:

- ❖ Develop the correct franchise structure for the objectives of the client, business and its environment (including stage of business and franchise lifecycle).
- ❖ Create a proper balanced relationship between the Franchisor and the Franchisees to ensure both parties prosper.
- ❖ Minimise the risk of failure or legal action from a disgruntled franchisee.

Remember that you will usually only get one chance of making your franchise system a success – you need to do it right the first time!

Financing your Franchise Programme

The cost of putting together all of the elements we have outlined and of course supporting the programme in its early stages might be relatively low. On the other hand the fully blown franchise development programme can be more expensive depending on the complexities of that programme. Of course, not all of this money will be paid out at once.

As a rule of thumb the sale of your first two franchises usually covers the cost of developing the franchise programme. On average it takes between four to six months to develop and put in place a franchise expansion programme. Although there is no real average time for recruiting a Franchisee, let's assume that you can recruit a Franchisee in twelve weeks and a second one in another twelve weeks. Many franchise systems are capable of recouping their development budget within the first twelve months of having decided to go into franchising.

In New Zealand all of the five major banks have franchise specialisation, and some (e.g., Westpac and ASB) have dedicated franchise divisions. They understand what franchising is all about and they are anxious to gain franchise customers because of the lower risk involved. Through their experience they know that franchise customers are good customers.

Once you have done your Feasibility Study and produced your Franchise Development Plan you can take it to one of the five major banks and use it in your quest to finance your franchise development programme.

Marketing your Franchise System

You've done all the planning and documentation of your new franchise system so now you need to recruit the best possible Franchisees to operate the franchised outlets.

The basic process of marketing a franchise system can be broken down into the following stages.

Planning the Recruitment Campaign

The objective is to create sufficient numbers of leads to be able to select your target number of franchisees. As with any product or service you cannot properly select a franchise without first determining who your potential market of likely franchisee is.

Therefore you must define your franchise market. This is usually done in the Franchise Development Plan stage, but is sometimes developed (or reviewed) just before launch.

Generating Leads for Prospective Franchises

This can be done in many ways such as word of mouth, Social Media, digital advertising, advertising in franchise magazines, 'Businesses for Sale' columns of the daily newspapers, canvassing recent redundancies, contacting accountants and lawyers in the targeted areas, exhibiting expos, etc. You must have worked out how you will appeal to your target market and draft the appropriate advertisement or alternative approach.

Converting Leads

The following up of leads is important and needs to be structured thoughtfully. This can be a long process and needs good support material. You need attractive sales information and brochures outlining the franchise opportunity. You need carefully thought out and worded documentation to control all the steps including, of course, a comprehensive Disclosure Document that complies with the requirements of the Franchise Association of New Zealand Inc.

All these brochures, forms and documents have to be used in the predetermined sequence to have the best chance of converting a prospect to a Franchisee.

The purpose of well-planned recruitment process and well-drafted recruitment documents is twofold:

1. To recruit the right type of franchisee
2. To mitigate any legal liability either at the time of recruitment or into the future

Getting Started Successfully

This stage is every bit as important as the earlier stages.

As soon as the Franchisee has signed the Franchise Agreement and has paid the entry cost or at least the required deposit (and completed the relevant Cooling Off Period), they should start their initial training. A good training programme will get a Franchisee off to a running start.

There are many different ways of training and establishing a Franchisee's business. It all depends on the type of business you are in. If it is a retail business you might have elected to start each Franchisee off with a 'turn key' operation. This means that all the site selection, fitout and stocking of an outlet has been completed by the Franchisor and in some cases the outlet has been launched and operated by the Franchisor's staff before handing it over to the Franchisee as a going concern. Other Franchisors prefer to get the Franchisees involved in site selection and all the set up operations so that at the time of launch the Franchisee has not only been through the initial training but knows first hand what it takes to get the outlet operational.

If your business is a service franchise a similar selection of methods are also available. Start the Franchisee off with fully developed systems and the right tried and proven techniques. Do not launch your franchise system prematurely without having ironed out all the bugs. This will ensure that your new Franchisee has the best possible chance of success and will save much time and possible ill-will in the future if you have to make alterations to poor systems. Again you need experienced advice to effectively undertake the franchise recruitment process.

Considering International Markets

More and more New Zealand franchisors and [indeed] non-franchised business are investigating exporting their businesses in a franchised or licensed format.

Overseas markets are attractive to local businesses, as they are often perceived to represent huge, untapped potential - many times New Zealand's size. For example, Australia has more than five times New Zealand's population.

Britain is similar in size to New Zealand but exceeds its population by a multiple of 15. The United States of America is much larger again – and each of the aforementioned countries have per capita income much greater than New Zealand.

Harnessing the potential of these and other overseas markets is an exciting prospect. Yet the prospect also presents a complex set of challenges that require addressing in a methodical and structured way.

Franchising offers good advantages for overseas expansion because it provides a lower cost alternative for establishing businesses in foreign countries. Franchising leverages your intellectual property. Again, as identified earlier, it is through the investment of local business people in these other countries that the majority of expansion costs are recovered.

Examples of absolutely critical factors to work through for international development include:

- Assessing your readiness for export
- Researching and ranking target countries for export
- Determining the feasibility of going international
- Determining an appropriate international entry plan
- Determining the appropriate franchised organizational form and commercial structure

What you are duplicating in foreign countries is not only the Franchisee operation but also the Franchisor operation. Having said that, both will require adaptation to reflect the uniqueness of the target country. In addition, adaptation will be required to reflect differences in both the type of commercial and franchising structure that is most optimal for the country you are entering.

This is where the business of the Franchisee and Franchisor needs to be well developed, organised and formalised so that the overall franchise system can be duplicated overseas effectively. This is why a well developed Franchisor Manual helps facilitate the seamless operation of running your franchise system in another country.

The duplication of that format needs to take into account the specific cultural, legal, accounting and business differences that exist in other countries.

The first step for franchise companies that are looking to expand internationally is to complete an International Franchise Development Plan. This plan needs to take into account the financial, personnel, operational and resource parameters of the company and the huge range of different structural options available for expansion. Evaluating the different structural alternatives is vital because small differences in structure can have a major impact on the level of international franchising success you are likely to have.

A common method used for franchised expansion overseas is that of Master Licensing, although it is only one of many. Master Licensing involves the granting of the right to a suitable person or company to operate your business format in another country. These licenses can be tight and precise as to the exact running of the franchise system or they can be more flexible allowing the local person considerable discretion. However, it is most important to get your franchise consultant to assist you create an International Franchise Development Plan for your chosen foreign country.

Although you will be able to use your domestic franchise programme as the basis of an overseas franchise programme, it may be necessary to use one/more of a number of different franchise forms. Added to that is the structure of the relationship between countries. This can take many commercial forms, such as a direct investment, joint venture or type of master franchise agreement.

If the Franchisor is prudent they will have done their homework well and researched the prospective market to know how best the franchise will be run in the foreign market.

If establishing a Master Franchisor in the target country is appropriate, some of this work can be done by them as part of their bid to become that licensed Master Franchisor. They should conduct a comprehensive feasibility study and write a business plan.

The formation and guidelines for this strategic planning will be given to the prospect by you because you know the questions that need answering. However they will have to do the research with their advisors and will have to pull it all together, providing a blueprint of how the local market will be penetrated, how the total operation will work and what profits it will yield.

The more that is planned for in advance and the less that is left to the local Master Franchisor or to chance, the better the results will be.

One of the keys, of course, is to attract the most appropriate Master Franchise. It is best to use a similar method as you would to attract excellent Franchisees in your home market. Go through a procedure that ensures that the successful candidate most closely fits the profile that you have devised. Be careful to limit any legal exposure to you or your system both now and for the future.

Preparation of all documents from sales brochures and letters, to the Disclosure Document, Master License or Master Franchise Agreements (where appropriate) and manuals must be well considered, totally accurate and in accordance with the law of the country.

It must be stressed that only when a business is operating successfully in New Zealand, using a satisfactory business format should you think of taking it offshore. Going to another country will not help solve any problems you might have domestically, it will only exacerbate them.

However, for a successful local company making good profits domestically, overseas expansion can provide the opportunity for exciting returns from markets many times New Zealand's size.

Why choose us?

When selecting a specialist to evaluate franchising your business it is important to know you are accessing the very best advice with the knowledge, training and experience to truly benefit your organisation.

Franchise Consultants are trusted advisors to many leading local and international companies. We provide personal service and expert guidance at all stages of franchising or licensing development – from the creation of the business format, to the building of a national or international brand.

For more than 30 years we have been New Zealand's leading management consulting company specialising in franchising and licensing.

You gain from us being at the forefront of franchising knowledge, research and practical operations experience.

Your business will have the use of unparalleled operational and academic experience and qualifications. Our team possesses post-graduate qualifications, franchising research and practical senior management experience with leading local and international brands, such as Coca-Cola, Bakers Delight, Star Mart, McDonald's and Subway.

You will receive considered analysis, independent impartial opinion and constructive advice.

We are a multi-year winner of the Franchise Association of New Zealand Westpac Service Provider of the Year award and were finalists in the Vero Excellence in Business Support Awards 2007, 2008 and 2009.

We have strong knowledge-sharing alliances with leading international franchising and licensing specialists.

Long-term Franchise Association of New Zealand (FANZ) support and involvement.

Authors of the New Zealand Franchisor's Guide, New Zealand Franchisee's Guide, and the Franchise Association of New Zealand's Franchisee Pre-entry On-Line Education Programme.

Home of the Franchising Best Practice 500, the authoritative list of franchise management best practices.

We are leaders in New Zealand franchising research into franchise sector sentiment, governance and recruitment.

Authors of the Franchise Consultants Franchising Confidence Index.



Our services include:

FRANCHISING A BUSINESS

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FRANCHISEE MANUALS

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FRANCHISEE PERFORMANCE GROUPS

FRANCHISEE SATISFACTION SURVEYS

FRANCHISOR EMPLOYEE SURVEYS

FRANCHISE RECRUITMENT MARKETING

FRANCHISE SYSTEM REVITALISATION

FRANCHISEE EXIT INTERVIEWS

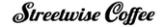
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