FRANCHISING

S.Sarala Lakshmi

6.1 Meaning of Franchising

Franchising is a system used by a company (franchisor) that grants others (franchisees) the right and license (franchise) to market a product or service under the franchisor's trade names, trademarks, service marks, know-how and method of doing business. It is a system for distributing products or services through independent resellers. It is a format of mutual dependence which allows both the franchisor and the franchisee realize profits and benefits.

6.1 Meaning of Franchising (Cont'd)

Some Terms Regarding Franchising

Franchisor:

The licensing company in the franchise agreement.

Franchisee:

The independent owner of a franchise outlet who enters into an agreement with a franchisor.

Franchise:

The right to use a specific business name and sell its goods or services in a specific city, region or country.

6.1 Meaning of Franchising (Cont'd)

Basic Ingredients of the Franchise:

The description of franchise system points out the crucial ingredients of a franchise business. They are-

6.2 Purposes of Franchising

The main purposes that are set to be achieved through business include the following-

- To restore individual entrepreneurship.
- To provide an easily recognized and accepted product or service.
- To compete with big business.
- To allow consumers to buy good quality items or services at the right price.
- To provide entrepreneurs a means to enter business with a low capital investment and risk.

6.3 Types and Arrangements of Franchise

Franchises are found in practice as under:

- **Sales Type Franchise**
- **Store Type Franchise**
- **Service Type Franchise**

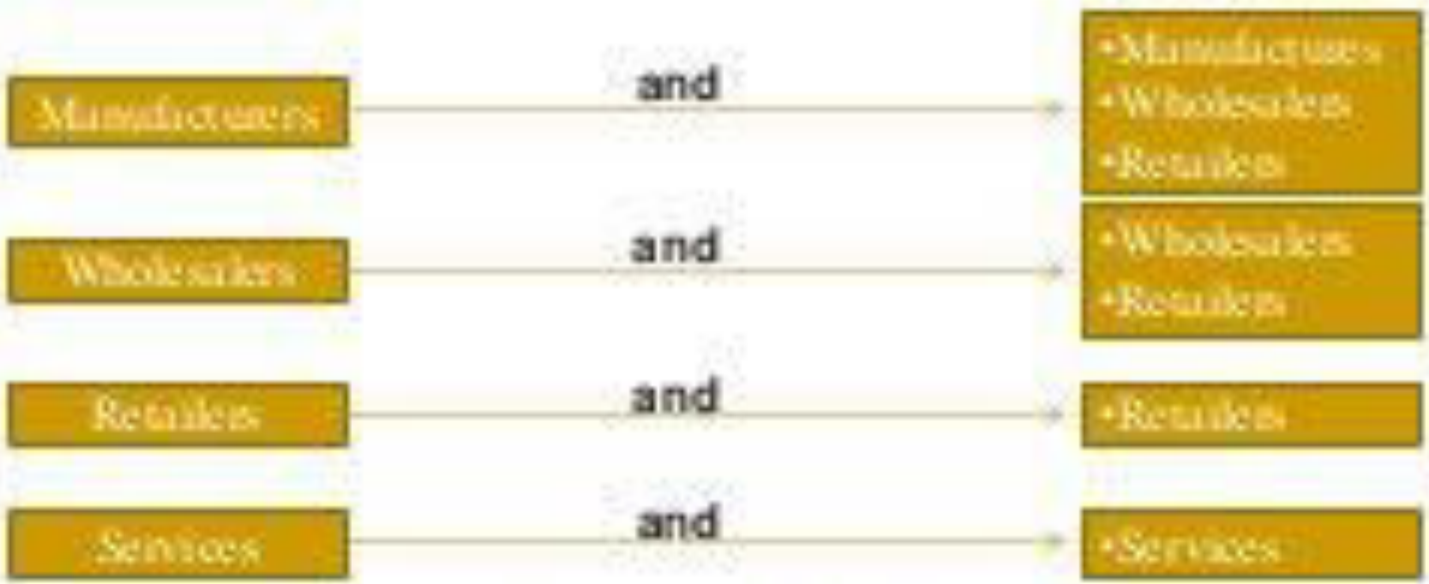

Figure: Channel link of Franchising

6.3 Types and Arrangements of Franchise (Cont'd)

Franchising agreements:

	Type	Description
01	Business Format Franchises	Based on a specific operating system; consist mainly of retail and service businesses.
02	Area Franchises	Franchisees that have the right to run franchise on territorial basis; this allows franchisee to develop entire city, state or region.
03	Single Unit Franchises	Franchisees that have the right to run franchise at only one site.
04	Multi Unit Franchises	Franchisees that have rights to open several franchise units at once.

6.8 Procedure for Evaluating franchise Opportunities

If the parties interested to become franchisees piously they should follow the undernoted seven procedures, the risk of being in the wrong footing may be minimized to a great extent:

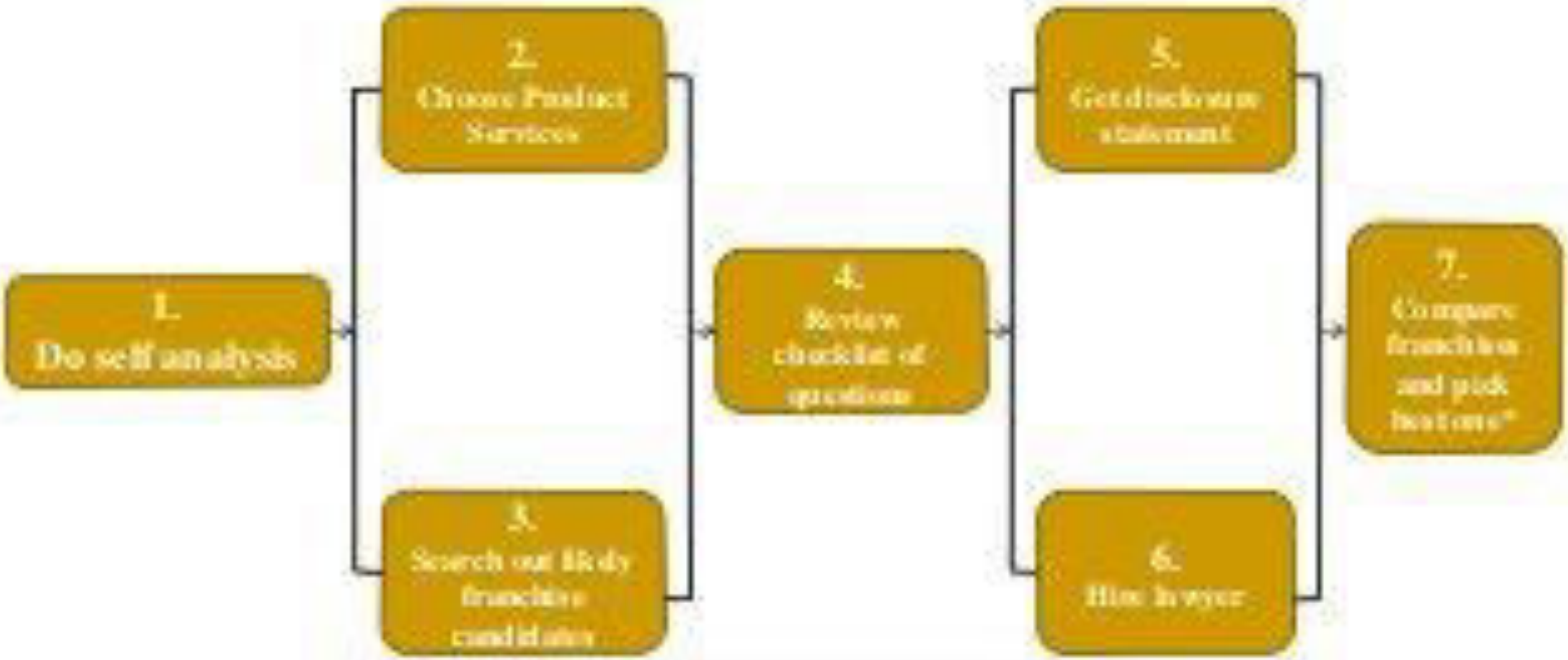

Figure 6A: procedure for Evaluating Franchise Opportunities

6.9 Franchise Agreement

A good basic franchise agreement will stipulate the conditions for both parties, and will contain information on:

1. Fees and initial cost
2. Product service method stipulations
3. Restriction upon purchase of materials
4. Record keeping requirements
5. Life of franchise
6. Termination
7. Royalties
8. Location and territorial rights
9. Training provisions
10. Controls of operations and performance standard

6.9 Franchise Agreement (Cont'd)

Obligations of the Franchiser and the Franchisee:

Franchisor Guarantees:

- Use of company name
- Management training
- Financial help
- Continuing management help
- Wholesale prices on purchases

Franchisee Obligations:

- Paying franchise fees
- Making minimum investment
- Meeting quality standards
- Following procedures
- Maintaining business relationship

6.10 Cost of Finance

Usually the initial franchise cost should include:

1. The franchise fee.
2. Land and building costs or lease deposits.
3. The location or site evaluation fee.
4. Working capital
5. Bookkeeping and Accounting Fees
6. Legal and Professional Fees
7. Insurance
8. Opening Product Quality
9. Utility Charges
10. Payroll
11. Debt Services
12. State and Local Licensee , Permits and Certificates

Cost of Finance (Cont'd)

A Method Of Arriving at the Cost of Buying an Existing Business Arriving at Ballpark Price:

1. Determine the total net asset value of the business: land, buildings, furniture, fixture, equipment, accounts receivable (if any), inventory, supplies, etc.
2. Subtract from net assets the total liabilities you will assume (if any). These include accounts payable, unpaid salaries, taxes, etc. this gives the adjusted tangible net worth of the business.
3. Determine the earning power of the business:
   a. *Compute earning power of tangible net worth. Multiply the net asset evaluation by a percentage factor. This is what one could earn on the same amount of money invested.*
   b. *Add the yearly salary that one could make by working elsewhere.*
   c. *Subtract the total of a and b (earning power and salary power) from the net profit of the existing business (average of the last three years- before owner's salary).*
   d. *This gives the personal earning power of the business.*

Cost of Finance (Cont'd)

4. Multiply earning power (Number 3) by the intangible goodwill factor. This "years of profit" figure would be:

   "-1"- if impact on community has been poor or management has been a detriment.

   "0"- if there is no value to goodwill.

   "1"- if the business has some intangible value, or it is a young business.

   "2"- if the business has had average acceptance in the community.

   "3"- if it is a very good and well-established firm.

   "4"- if it has an excellent reputation and is a well-seasoned business.

5. Add this figure (Number 3 X Number 4) to the tangible net worth (Number 2)
6. This gives an estimate of a fair final price to be paid for the business

6.11 When Owning a Small Business Through Franchise is not Advisable?

Under the following situations owning a small business through franchise is not advisable:

- No Sizable Demand
- Discouraging Buying Habits
- Too Many Litigations
- Existent Franchises
- No /Declining Goodwill
- Unsatisfactory Financial Transactis
- Unfavorable Terms

6.12 Financial Arrangements for the Franchisees

The franchisee, depending on such factors as his own character, the use pattern of funds, and plan for repayment, has the option of a variety of types of loans from lending institution. The principal types of bank loans are:

i. Straight Commercial Loans
ii. Term Loans

Bank may grant either unsecured or secured loans. The forms of security may vary, such as the ones:

a. Endorsements, co-makers and guarantors may personally give surety for repayment
b. Assignment of leases
c. Warehouse Receipts
d. Trust Receipts; and
e. Chattel Mortgage

Other collateral type of loans offered by banks are:

- loans on the franchisee's accounts receivables
- assigned savings
- cash surrender values of life insurance policies
- securities such as stock and bonds

6.13 Checklist for Evaluating a Franchise

On the Franchise Opportunity Itself

1) Did your lawyer approve the franchise contract after he studied it paragraph?
2) Dose the franchise call upon you to take any steps which are, according to your lawyer, un-wise or illegal in your state, country, or city?
3) Under what circumstances and what cost can you pull out of the franchise contract?
4) If you sell your franchise, will you be paid for your goodwill, or will the goodwill you have built into the business be lost by you
5) Does the franchise give you an exclusive territory for the length of the franchise?
6) Is the franchisor connected in any way with any other franchise companies handling similar merchandise or services?
7) If the answer to the last question is yes, what is your protection against this second franchise organization?

Checklist for Evaluating a Franchise (Cont'd)

On the Franchisor:

1) For how many years has the On the franchisor been in business?
2) Will the franchisor you with:
   a) *A management training program?*
   b) *An employee training program?*
   c) *A public relations program?*
   d) *Merchandising ideas?*
   e) *Franchising?*

3) Will the franchisor help you find a good location for your franchise?
4) Is the franchisor adequately financed so that it can carry out its stated plan of financial
   help and expansion?

Checklist for Evaluating a Franchise (Cont'd)

5) Is the franchisor a one-man company with a trained and experienced management team-so that there would be always an experienced person as head?

6) Exactly what can franchisor do for you which you cannot do for yourself?

7) Does the franchisor have a reputation for honesty and fair dealing among the local entrepreneurs holding its franchise?

8) Has the franchisor shown you any certified figures indicating exact net profits of one or more going franchises, which you yourself checked with the franchisee?

9) Has the franchisor investigated you carefully enough to assure itself that you can successfully operate one of their franchise at a profit both to them and to you?