

Franchising for Start-ups

The franchise approach

A business idea for a start-up doesn't have to be original. Many new businesses are formed with the intention of offering **an existing business idea**. The use of **franchises** is a great example of that.

The basic idea for a franchise is this.

A **franchisor** grants a licence (the "**franchise**") to another business (the "**franchisee**") to allow it to trade using the brand or business format.

That might sound a bit complicated! The trick is to remember that the **franchisor is in charge** - the franchisor is the original owner of the business idea.

Franchises are a significant part of business life in the UK:

- Franchises generated annual sales of £12.4 billion in the UK in 2007
- There are over 800 different franchised business formats in the UK and that number is rising by around 5% each year
- The average sales turnover per franchise outlet is £360,000
- 90% of franchises are reported to be profitable
- A franchise has average borrowings of £70,000, suggesting that banks are happier to make loans to franchise businesses than other start-ups
- The typical franchisee is aged 47. 66% are men and 86% of franchisees are married!
- Franchises are particularly popular in the service sector

Examples of well-known businesses that use franchising to expand their operations include:

- Subway
- McDonalds
- Starbucks
- Pizza Hut
- Thorntons
- Molly Maid
- Prontaprint

You might have noticed from the list above that nearly all those businesses provide **services** rather than produce **goods**. Franchising is particularly suitable for service businesses.

Advantages of running a franchise

For a start-up entrepreneur, there are several advantages to investing in a franchise:

- It is still your own business – even if you are sharing the profits with the franchisor

- The investment should be in a tried and tested format and brand
- The franchisee gets advice, support and training. The franchisor will also supply key equipment, such as IT systems, which are designed to support the operation of the business
- It is easier to raise finance - the high street banks have significant experience of providing finance to franchises
- No industry expertise is required in most cases
- The franchisee benefits from the buying power of the franchisor
- It is easier to build a customer base – the franchise brand name will already be established and many potential customers should already be aware of it
- The franchisee is usually given an exclusive geographical area in which to operate the franchise – which limits the competition (since operators of the same franchise are not in direct competition with each other)

Overall, investing in a franchise is a **lower risk method** of starting a business and there is a lower chance of **business failure**

Disadvantages of running a franchise

There are several disadvantages for the franchisee:

- Franchises are not cheap! The franchisee has to pay substantial initial fees and ongoing royalties and commission. He/she may also have to buy goods directly from the franchisor at a mark-up
- There are restrictions on marketing activities (e.g. not being allowed to undercut nearby franchises) and on selling the business
- There is always a risk that the franchisor will go out of business
- The franchise needs to earn enough profit to satisfy both the franchisee and franchisor - there may not be enough to go round!

There are many good franchise opportunities available for a start-up, but some poor ones too. So there is still a need for the entrepreneur to do market research into the franchise

A franchise is a kind of "halfway house" for a budding entrepreneur. It is a lower risk method of market entry and it is often easier to raise finance. However, running a franchise does not offer the same kind of long-term financial rewards that owning a business outright can.