



# Franchising Know-How

## FRANCHISOR OR FRANCHISEE?

### What does it mean to you?

The idea of franchising makes you think of fast food restaurants or real estate brokers. But did you know that almost any type of business could be a franchise? That is because a franchise is merely a legal document that defines a commercial relationship between the owner of a trademark, service mark, trade name or advertising symbol and an individual or group that wants to use that identification in business.

If you own a trademark you can choose to distribute your product all by yourself, or you can create a contract with others who wish to distribute the product you created. In the simplest form, a franchisor owns the right to the name or trademark, and sells that right to a franchisee. This is known as a *product/trade name franchising*.

We generally think of franchises in the more complex form, *business format franchising*, where a broader and ongoing relationship exists between the two parties. This type of franchise often provides a full range of services including site selection, training, product supply, marketing plans, and even assistance in obtaining financing.

Many new small business owners choose to buy a franchise over creating a new business of their choice because it seems less risky. Let us consider some of the advantages and disadvantages of such a choice:

### ADVANTAGES

- \* Established product or service
- \* Technical & managerial assistance
- \* Quality control standards
- \* Less operating capital
- \* Higher probability of survival
- \* Opportunities for growth, subfranchisees
- \* Potential lower cost supplies because of quantity purchasing
- \* Use of franchisor's secret methods

### DISADVANTAGES

- \* High costs of agreement
- \* Too high expectations of success
- \* Over dependence
- \* Fixed performance standards
- \* Competition with performance of other franchisees
- \* Restrictions on freedom of decision
- \* No choice of suppliers
- \* Fear of termination of agreement

Every franchise contract is different for the various types of business. In general, the more services provided by the franchisor, the higher the fees. There is the original franchise purchase price, and the fees charged for ongoing services.

Regardless of whether you plan to be a franchisee or to start a franchise business of your own it is important to know what belongs in a franchise contract. Remember that this document is the foundation of your business agreement.

Fourteen states have franchise disclosure or registration laws that require the franchisor to submit documents to state authorities. The Federal Trade Commission in all states requires a lengthy disclosure document and financial statements be given to the franchisee before purchasing the franchise. A good lawyer is a necessity. He or she can help you be sure you understand the legal terms.

### **Franchisors are required to give you:**

- ! a copy of their Uniform Franchise Offering Circular (UFOC) at least ten days before you sign the agreement. This is a standardized promotional piece that discloses estimates of startup costs. However, under federal law, the franchisor cannot make claims about how much money you will make.
- ! copy of the franchise agreement, other contracts, and the franchisor's financial statements.
- ! the business operational manual with one week of training in one of the parent stores, and ongoing support and assistance.
- ! guidelines on audits and rights to sell the franchise (assignment rights)
- ! information on franchisee's initial licensing fees and other ongoing costs (e.g. royalties, promotional fees, cooperative advertising fees).

There are a number of other items a franchisor should provide but are not required by law to do so. Often the fee is affected by provision of these items. They include:

- ! Promotional assistance in the form of a marketing plan, promotional materials, advertising, publicity etc.
- ! Assistance in selection of area site.
- ! Adequate insurance coverage (fire, inventory, burglary, accident and health insurance, liability etc.).
- ! A trademark that will distinguish the business from competition.
- ! Guidelines on the purchase of inventory and equipment.
- ! Written requirement on restrictions on goods sold.
- ! Restrictions as they apply to competition with other company franchisees.
  - ! Terms of agreement and renewal

### **NOW FOR THE CONTRACT**

When you have a clear understanding of all of these issues you are then ready to deal with the franchise contract. It consists of two main parts: 1) the purchase agreement and 2) the franchise or license agreement.

1. The Purchase Agreement of the contract covers:
  - a. The Franchise Package, consisting of an equipment and inventory list to be provided to the franchisee.
  - b. The Price, the specifics of price and method of payment related to stages of delivery of equipment etc.
  - c. The Services, a list of the franchisor's responsibilities to the franchisee. Those to be provided before the business opens are called the initial services. Those services to be provided periodically thereafter are called continuous services.

2. The Franchise or License Agreement of the contract covers:
  - a. The rights granted to the franchisee. This will confirm all the details you have been told and should be specified in the detail expected by you.
  - b. The obligations undertaken by the franchisor both before and after startup. This is related to the UFOC and it is generally attached.
  - c. Obligations of the franchisee
  - d. Trade restrictions imposed on the franchisee by the franchisor
  - e. Agreements regarding assignment of ownership to others or termination of contract.

As in any contract situation, a clear understanding of the responsibilities of both sides avoids future misunderstandings and conflicts. It pays to take the time to consider the options and negotiate the best contract possible.

## **ACTIVITIES**

1. Divide the class into small groups. Each group should pick a local franchise and brainstorm the advantages and disadvantages of owning it versus a similar local business. (You will find that you probably don't have enough information to do this completely. Therefore move to activity number 2).
2. Interview franchisees in the area to learn what they believe are their advantages and disadvantages in owning their own franchise. Share your findings with the class. Compare the answers from different types of franchises and see if you can determine which franchise is most desirable.
3. In small groups pick a business franchise to use as the basis for creating a franchise contract. Make a list of the items that would need to be included in all parts of the franchise contract. Be specific in estimating all necessary details. Next, pair up with another class member to sell him or her this franchise. See what items you can both negotiate to your advantage.
4. As a class, discuss whether you would want to franchise out your own business idea some day. What types of businesses would be best suited to this? When would you decide to become a franchisor? What are the advantages to you? What are the disadvantages?

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This activity was developed for publication in *Entrepreneur News & Views* and was adapted from information on franchising available from the U S Small Business Administration. Teachers/instructors are hereby granted free permission to duplicate for use in the classroom.