

The ABC's of Franchising
PIZZIGIS-R-US

Presented by
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SBA Your Small Business Resource
 U.S. Small Business Administration


Success!

- Statistics provided by the U.S. Chamber of Commerce show that chances of success in a franchising operation are much greater than those of operating a business from scratch or even purchasing an existing business.

The Relationship

- Franchising is a relationship between a company that wishes to franchise its business (the franchisor) and a person who wants to operate the franchise (the franchisee).

First Franchise: Singer Sewing Center 1858



- Isaac Singer invented the sewing machine but had two problems:
 - Lack of capital to mass manufacture
 - Consumers had to be taught to sew
- Local business owners sold and trained users
- Fees paid for manufacturing

Common Franchise Myths

- Buying a franchised business is a guarantee of success.
- The franchisor looks out for the best interests of the franchisee.
- You get a proven operations system with a franchise.
- The franchise comes with complete training.

Do You Have What It Takes?

Can you:

- Follow a system?
- Tolerate different views?
- Accept consensus?
- Accept criticism?
- Organize the work of others?
- Work long hours?



Stand Alone vs. Franchisee

- | | |
|--|--|
| <ul style="list-style-type: none">• <u>Stand Alone</u>• Courageous• Independent• Visionary• Higher risk taking• Loner | <ul style="list-style-type: none">• <u>Franchisee</u>• Cautious• Open to guidance• Methodical• Lower risk taking• Interactive |
|--|--|

Advantages

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- Based on proven idea
- Recognized brand name or trademark
- Training available
- Exclusive territory rights
- Group Advertising Power
- Strength in numbers lead to economies of scale in purchases
- Financing may be easier
- Risk is reduced and shared by franchisor
- Supplier relationships established
- Accounting and management support available

Disadvantages

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- Higher costs
- Supplies available only from franchisor
- Business restrictions
- Selling restrictions
- Lower risk = lower profits
- Regional disconnect
- Franchise fee
- Change in business model (Dairy Queen)
- Franchisor may go out of business
- Rogue franchisees
- Territory disputes

Legal Issues

- Federal Trade Commission (FTC)
 - Rules Governing Franchise Agreements
 - Uniform Franchise Disclosure Document (UFDD), replaces:
 - Uniform Franchise Offering Circular (UFOC)
- All 50 states recognize FTC
- Some states have added regulations
- North Dakota follows FTC w/additions

UFDD

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- UFDD is a legal document used in the franchising process in the United States.
- Franchisors must give a UFDD to franchisees at least 10 business days before any contract is signed and before any money changes hands.
- Covers 23 main points (see handout)

Check date to ensure it is the latest UFDD

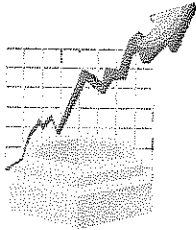
How Do You Find the Right Franchise

- Decide what you want
- Develop a three-tiered strategy
 - Entry strategy
 - Operating strategy
 - Exit strategy
- Determine what you expect from the franchisor
- Research opportunities

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Don't Fall for a Pretty Face!

- Marketing Materials are Very Persuasive



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Example: Grins 2 Go Support

- GRINS Academy
 - 2-week training
 - Operations Manual
- On-Going Support
 - Toll-Free Support
 - Intranet
 - National Booking Center
 - www.grins2go.com
 - Strong Marketing (SMILES™)
 - Monthly Huddles & E-Learning
 - New Product Innovation
 - Maven
 - Weekly Spin
 - Monthly BLR



Be Cautious, Careful & Demanding

- Limit your search to franchise systems that recognize and work with an independent association of its franchisees.
- Assemble a "Dream Team" of advisers to help you understand your business requirements.
 - Knowledgeable franchise attorney
 - Accountant
 - Banker
 - Business Consultant (SBDC)

A Five Step Plan

- Step 1: Read disclosure documents
- Step 2: Interview franchisees & franchisors
- Step 3: Visit franchise locations
- Step 4: Visit the franchisor's home office
- Step 5: Estimate costs and earnings

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Questions to Ask of Franchisee

- Are you satisfied with the franchisor?
- Is your franchise profitable?
- Is it the profit you expected?
- Are your costs in line with what was promised?
- Is delivery of goods from the franchisor adequate?
- Was the training provided adequate?
- Have you had any disputes with your franchisor?

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Questions to Ask of Franchisee

- Does the franchisor listen to your concerns?
- Do you know of any trouble the franchisor has had with other franchisees?
- Do you know of any trouble the franchisor has had with the government or local authorities?
- Are you satisfied with the marketing and promotional assistance the franchisor has provided?
- Have the operations manuals proved useful?

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Franchisor Checklist

- Is the franchisor a one-person firm or a large corporation with experienced management?
- Are you offered an exclusive territory?
- Does the franchisor provide financing?
- Will the franchisor assist you in finding a location?
- Are there restrictions on what items you can sell?
- What is the extent of the training the franchisor will provide for you?

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Franchisor Checklist continued

- What are the exit terms?
- Does your prospective franchisor allow variances in the contracts of some of his or her franchisees?
- How successful is the franchise operation?
 - Dunn and Bradstreet reports
- Has the franchisor been involved in previous bankruptcies or franchise related litigation?

Estimating Costs

- Operating Expenses – One to three months
- Inventory – Don't overbuy and know lead times
- Training – Requires travel, time & hotel
- Equipment – Make sure technology is up to date
- Building/Leasehold Improvements
- Professional Fees – Attorney, accountant, insurance agent
- Local Advertising – yellow pages, coops, etc
- Signage

Estimating Costs to Franchisor

- Franchise Fees
 - Paid for the right to use the franchise name
 - Fees vary from industry to industry
- Royalties – paid on a weekly, monthly, quarterly, or semi-annually based on a percentage of gross
- National Advertising charge (2 to 5%) to cover building the brand name

Estimating Revenues

- Franchisors are reluctant to make claims (on paper)
 - They may disclose an anonymous listing of franchise gross sales
- Talk to other Franchisees
- Keep in mind to adjust based on your particular market size

Five-Step Plan for Revenue Est.

1. Identify "Royalty Payments" in the franchise financial statement in the franchise agreement
2. Add up the number of outlets in the system
3. Subtract out number of corporate owned stores
4. Divide royalty payment by number of non-corporate owned stores
5. Divide average royalty payment per store by the royalty rate in the franchise agreement

Example

1. Royalty Payments: \$1.5 million
2. Total stores: 85
3. Corporate stores: 10
4. Average royalty payment: \$20,000

5. Average Gross (3% royalty fee): \$20,000/.03
\$666,667

Cash Flow Sheet: Cash-in Section

Figzigs-R-Us 11/2/2008 10:25	Pre-start up	Feb-11	Mar-11	Apr-11
CASH ON HAND (owner equity and grant)	\$15,000	\$5,000	2,500	2,000
CASH RECEIPTS				
Cash Sales -- Service		2,000	3,000	3,000
Cash Sales -- Product		1,000	1,500	2,000
Collections from credit accounts		0	500	1,500
Loan or other cash injection (specify)	\$75,000			
TOTAL CASH RECEIPTS (2a+2b+2c=3)		3,000	5,000	7,500
TOTAL CASH AVAILABLE	\$90,000	8,000	7,500	9,500

Cash Flow Sheet: Cash-out Section

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CASH PAID OUT				
Supplies/product	10,000	2,000	2,000	3,000
Payroll		2,500	2,500	3,000
Rent		1,000	1,000	1,000
Equipment	18,000			
Franchise Fee	50,000			
TOTAL CASH PAID OUT	\$78,000	\$5,500	\$5,500	\$7,000
TOTAL CASH AVAILABLE	\$12,000	\$2,500	\$2,000	\$2,500

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Cash Flow Sheet: Cash-out Section

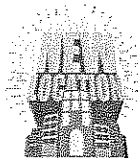
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Rent		1,000	1,000	1,000
Equipment	18,000			
Franchise Fee/Royalty	50,000			1,000
TOTAL CASH PAID OUT	\$78,000	\$5,500	\$5,500	\$8,000
TOTAL CASH AVAILABLE	\$12,000	\$9,500	\$9,000	\$8,500

Is There "Enough Demand?"

- Market Research: Determining if there is enough customers in your market area who will buy your product at "your" price.
- Who are my customers
- How often do they buy?
- Where do they live?
- How do they buy?
- What hours do they buy?
- What kind of people are they?
- Rural
- Educated
- Homeowner
- Blue collar
- Apartment
- Women
- Young/old

Location Issues

- Traffic patterns
- Visibility/signage concerns
- Ease of access to location
- Parking spaces
- Square footage requirement
- Does building meet required business codes associated with the franchise?
- Public transportation?
- Hours of operation (mall)
- Presence of competing businesses



Business Plan Outline

- Executive summary
- Business description
- Market served
- Competition
- The product or service
- Management team
- Personnel needs
- Financial data
 - Start-up costs
 - Cash flow analysis
- Investment returns
- Appendices

Franchise Funding

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Franchising provides both plusses
and minuses to the funding equation!

- ↳ Past success record
- ↳ Franchisor support
- ↳ Little flexibility to finesse start-up costs
- ↳ Royalties cut into cash flow

Other Restrictions

- Owner Equity Minimums
- Investor Restrictions
- Net Worth Minimums

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SBA Franchise Funding

- SBA lends to small businesses
- Not all franchises are eligible
- www.franchiseregistry.com

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Catch 22 Dance



Securing a franchise has been likened to a long, slow, courtship. You want to know indiscreet things about your partner before you commit and vice versa. There is a lot of jockeying taking place to ensure the franchise is the right fit for you and for the franchisor to decide if you are the right fit as well.

Three Sources of Franchise Financing

- **Owner Equity:** Cash from personal wealth
- **Debt Financing:** Taking out a loan from a funding source and paying interest on it.
- **Equity Financing:** Obtaining funds from investor in exchange for giving up a part of ownership in the business. Investor believes buying into the business is a good investment.

Funding Sources for Entrepreneurs

- Personal Savings
- Bank Loans
- Franchisor
- Friends and Relatives
- Partnerships
- Angel Investors
- Venture Capitalists
- Development Corporations
- Personal Credit Card
- Suppliers/Customers
- Insurance Policies
- Pension Funds
- Community Groups
- Grants

Before seeking financing you must answer the following questions:

- When are you going to repay the money?
 - How much time will it take to become profitable?
- How much do you need?
 - Business plan financial section
- Can you afford the cost of money
 - Loan rates
 - Outside investor terms

Understanding Commercial Lending

- Choosing a lender and developing a solid relationship is very important factor in the success of your business!
- Lenders provide more than funds.
- Lenders do not “invest.”
- Lenders have a self interest in your long-term success.

Step One: Contact the Bank

- Ask commercial lender if they are looking for your size and type of loan
- Ask for a loan application
- Prepare all requested documents and include a business plan (help available)
- Make an appointment
- Rehearse your proposal

Step Two: Prepare for Meeting

- Dress properly and be on time
- Bring multiple copies of business plan and other application materials
- Plan a presentation of 30 minutes or less
 - Give an overview of presentation at beginning
 - Summarize key points at end
- Be prepared to back up your claims
- Follow up with a *“Thank You”* note

Show Sources and Usage of \$

Fund Sources	
Bank Loan	\$180,000
Owner Equity	90,000
Other Investor	20,000
Total	\$290,000
Uses of Funds	
Working Capital	\$25,000
Equipment/Machinery	110,000
Furniture/Fixtures/Equip	65,000
Franchise Fee	90,000
Total	\$290,000

Questions?

The ABC's of Franchising

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U.S. Small Business Administration



The ABC's of Franchising: UFDD

UFOC is an abbreviation for "Uniform Franchise Disclosure Document", a legal document used in the franchising process in the United States. Franchisors must give a UFDD to franchisees at least 10 business days before any contract is signed and before any money changes hands. It contains extensive information about a franchisor, which is intended to give potential franchisees enough information to make educated decisions about their investments. The information is divided into 23 categories:

1. The Franchisor, its Predecessors and Affiliates
2. Identity and Business Experience of Key Persons
3. Litigation History
4. Bankruptcy
5. Initial Franchise Fee
6. Other Fees and Expenses
7. Franchisee's Initial Investment
8. Restrictions on Sources of Products and Services
9. Obligations of the Franchisee
10. Financing Arrangements
11. Obligations of the Franchisor
12. Territory
13. Trademarks
14. Patents and Copyrights
15. Obligation of the Franchisee to Participate in the Actual Operation of the Franchise Business
16. Restrictions on Goods and Services Offered by the Franchisee
17. Renewal, Termination, Repurchase, Modification and/or Transfer of the Franchise Agreement
18. Public Figures
19. Earnings Claims
20. List of Franchise Outlets
21. Financial Statements
22. Contracts
23. Acknowledgment of Receipt

