



Answers to the IFA's 21 most frequently asked questions about franchising

The Entrepreneur's Source, in cooperation with the International Franchise Association (IFA), is pleased to offer you answers to the IFA's 21 most commonly asked questions about franchising.

1. What is franchising?

Franchising is a method of distributing products or services. At least two levels of people are involved in the franchise system: (1) the franchisor, that lends their trademark or trade name and a business system; and (2) the franchisee, who pays a royalty and often an initial fee for the right to do business under the franchisor's name and system. Technically, the contract binding the two parties is the "franchise," but that term is often used to mean the actual business that the franchisee operates.

2. How does a franchised business start?

Imagine a store owned by an individual with a particular concept. If the business is successful, the owner may develop a second or third store and hire employees for the day-to-day operations. At that point, if the entrepreneur still wants to expand but prefers not to operate additional stores himself or herself, he or she may decide to "franchise" the store name and business system to an independent business person a franchisee. In return, the entrepreneur may ask for an initial fee and/or a continuing royalty payment based on a percentage of that franchisee's sales. The business is now franchised

3. When I visit a store in my area, for example, a well-known fast food restaurant, how can I tell whether that restaurant is operated by the franchisor or a franchisee?

It's difficult to tell just by visiting the restaurant. However, if it is a franchise, there should be some signage in the restaurant which indicates that the restaurant is independently owned and operated. Many companies have stores that are operated by franchisees but also have stores that are company owned and operated. So it's entirely possible that of two stores with the same name, one may be operated by a franchisee and the other operated by the company. In either case, the products, services, and quality should be the same.

4. How widespread is franchising?

The answer may surprise you. In 2000, most analysts estimated that franchising companies and their franchisees accounted for \$1 trillion in annual U.S. retail sales from 320,000 franchised small businesses in 75 industries. Moreover, franchising is said to account for more than 40 percent of all U.S. retail sales. Industry analysts estimate that franchising employs more than 8 million people, a new franchise outlet opens somewhere in the U.S. every 8 minutes, and approximately one out of every 12 retail business establishments is a franchised business.

5. Where do franchise sales come from?

Most franchise sales are still by product and trade name franchise chains car and truck dealerships, gasoline service stations, and soft drink bottlers. In 1992, the last year for which statistics are available, business format franchise sales were \$249 billion; sales by product and trade name franchises were \$554 billion. Growth in the product and trademark sector of franchising has been slowing in recent years, however, while the number of outlets and total sales of "business format" franchises are expected to continue to grow and even increase their growth rate.

6. What is "business format" franchising?

In business format franchising, the franchisor prescribes for the franchisee a complete plan, or format, for managing and operating the establishment. The plan provides step-by-step procedures for major aspects of the business and, anticipating most management problems, provides a complete matrix for management decisions confronted by the franchisees. The major advantage of buying a business format franchise is that the system, the means for distributing goods and or services, has been developed, tested, and associated with the trademark. As a result, rapid expansion of a successful retail concept can occur more quickly than through company-owned expansion.

Sales by business format franchisors continued to increase steadily throughout the early 1990s. Some analysts indicate that sales through franchised establishments have grown faster than the gross domestic product. Retail sales from franchise businesses have been said to account for 15 percent of the U.S. gross domestic product. Although there is no really good recent data on the extent of franchising in the U.S., most analysts have stated that business format franchising accounts for approximately 27 percent of all franchising sales, 68 percent of all franchise establishments, and 74 percent of employees of franchised businesses.

7. What are the major growth industries in "business format" franchising?

As the economy becomes more service and technologically oriented, as more women enter the work force, and as a larger percentage of the population grows older, growth areas in franchising are responding to these changes. The industry categories in franchising that are expected to continue to experience rapid growth for the start of the new century are service-related fields such as home repair and remodeling, carpet cleaning, household furnishings, and various other maintenance and cleaning services; all business support services including accounting, mail processing, advertising services, package wrapping and shipping, personnel and temporary help services, and printing and copying services; automotive repairs and services such as quick-lube and tune-up; and other areas such as

environmental services, hair salons, health aids and services, computers, clothing, children's services, educational products and services, and telecommunications services.

While it is important to consider industry growth before investing in a franchise, it is more important to analyze an individual franchise company's track record, keeping in mind that quick growth does not always spell success. A franchise organization that grows too quickly might not have a service team in place to support all of the units properly. Overall, long range trends indicate a steady, solid growth in business format franchising. Some will fall by the wayside, as is natural with any business, but others may well be the "household name" franchise success stories of tomorrow.

8. Specifically, what kinds of businesses lend themselves to franchising?

Virtually every business form you can imagine. The International Franchise Association now lists more than 75 different categories to describe its members. Typically, you would think of fast food and restaurants first when thinking of franchising, but franchising covers the spectrum from almost A to Z from advertising/direct mail to construction, to dating services, to home inspection, to security systems, to video sales and rentals. Printing and copying services, maid services, computer services, cleaners, lawn care services, real estate, hotels and motels, and travel agencies are excellent examples of successfully applying franchising to established industries.

9. Are the "look-alike" characteristics of franchises a disadvantage? Don't consumers want variety?

The increasingly mobile American consumer has come to depend on and appreciate the consistent quality of franchised products and services. Today, no matter where they go, people expect and want the same quality, which is why consumers so often stop at franchised establishments. The ability to easily recognize a franchised store, restaurant or hotel from the outside guarantees there will be no surprises or disappointments on the inside. Quite simply, the public knows it and wants it that way.

10. What should I consider before buying a franchise?

Among the points which IFA recommends for investigation are:

- a. The type of experience required in the franchised business;
- b. A complete understanding of the business;
- c. The hours and personal commitment necessary to run the business;
- d. Who the franchisor is, what its track record has been, and the business experience of its officers and directors;
- e. How other franchisees in the same system are doing;
- f. How much it's going to cost to get into the franchise;
- g. How much you're going to pay for the continuing right to operate the business;
- h. If there are any products or services you must buy from the franchisor and how and by whom they are supplied;
- i. The terms and conditions under which the franchise relationship can be terminated or renewed, and how many franchisees have left the system during the past few years; and
- j. The financial condition of the franchisor and its system.

11. What is the federal trade commission franchise rule?

It is a federal regulation which requires franchisors to prepare an extensive disclosure document and to give a copy to any prospective franchise purchaser before he or she buys a franchise. The disclosure document typically used to comply with the Rule is called a Uniform Franchise Offering Circular, or UFOC. Within the UFOC are 23 different categories of information about the franchise, including those mentioned above. Required fees, basic investment, bankruptcy and litigation history of the company, how long the franchise will be in effect, a financial statement of the franchisor, earnings claims (if the company makes them) . . . all are presented in this disclosure document. IFA recommends that both your attorney and your accountant review the UFOC and your franchise agreement.

12. How can I be sure that the information provided in the disclosure document is truthful and accurate?

Even though inaccuracy and misrepresentation carry civil and sometimes severe criminal penalties, there is no way to be absolutely sure. The disclosure document makes fraud and deception less likely. However, because the franchisor has -- under penalty of law -- answered in written (or electronic) form a variety of very important questions you can use to judge the offer, IFA recommends that you carefully consider the information provided and evaluate the materials, including the history and reputation of the company and its officers, with the assistance of your lawyer and accountant. Also, be absolutely sure you talk to a substantial number of others who have already obtained franchises from the company you're considering, and ask them to verify any information you question. Learn if they are "satisfied customers" of the franchisor.

13. Are there any other laws which protect me?

Fourteen states require franchise companies to file or register their franchise offerings with a state agency: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin. These states, plus Oregon, also have disclosure regulations similar to those of the Federal Trade Commission. By means of so-called "business opportunity laws," certain other states regulate the offer and sale of a "business opportunity" which may include the offering of a franchise under the state's definition of a "business opportunity."

14. If I want to buy a franchise, what should I do to get started?

The first thing to do is to identify companies offering franchises and determine how much you can afford to invest. Careful investigation prior to purchasing a franchise also necessitates that you examine and understand what the franchise entails. For instance, you need to inquire into the training and support provided, assistance in finding and developing a location, and the sources of inventory and supplies. You should research the company's growth and prospects for future growth. You should also seek advice from professionals and businesspeople you respect. By investigating wisely, you can make an informed decision on whether to purchase the franchise.

15. What kind of investment is necessary to buy a franchise?

Investment requirements differ tremendously. It all depends on the industry and the type of business. Total start-up costs can range from \$20,000 or less, to over \$1,000,000, depending on the franchise selected, and whether it is necessary to own or lease real estate to operate the business. Moreover, the initial franchise fee for most franchisors is between \$20,000 and \$40,000. In an IFA survey conducted in 1998 on franchising, 88 percent of franchisors charge an initial franchise fee of \$40,000 or less. The survey also revealed that an average investment, excluding real estate costs, was \$318,975. However, there are many great franchise options at all investment levels.

16. Would I make a successful franchisee?

A successful franchisee should be suited to the industry of which he or she is a part, suited to the particular franchise company, and suited to the franchise system generally. Important questions to ask yourself include: Am I suited to the industry physically and by experience, education, learning capacity, temperament and financial ability? What type of work is most appealing to me; for example, do I enjoy working with food, mechanical things, people, real estate, books and recordings, sporting goods, etc.? Am I prepared to work hard and take financial risks? Do my advisors, family, and friends think I am adaptable and trainable? How do I react to controls? Am I a "loner", resenting authority and restraints, or can I accept guidance and direction happily? If I prefer to act as a passive investor in the franchise, will the company accept this? How do I personally feel about the company's image and products and services? The right answers to these types of questions help determine your potential success as a franchisee.

17. How do you explain the success rate for franchised businesses?

"Success" is a subjective term. A September and October 1997 Gallup Organization study on franchise owner's and attitudes towards their franchise experience revealed that more than nine of ten franchise owners stated that they considered their franchise to be somewhat or very successful. Two of three respondents said that they would not have been successful if they tried to open the same business on their own. The franchising system is designed to provide a formula for operating a successful business. Unavoidable business mistakes have been worked out of the system through experience and the franchisor is available to assist when new challenges arise. The Small Business Administration says most businesses fail from lack of management skills. With a franchised business, your franchisor should be eager to help you overcome problems. Your hard work and the franchisor's expertise spell a strong partnership.

18. How can I be sure I won't lose money?

No one can be 100 percent sure. Although the majority of franchisees are satisfied, successful business people, some do suffer financial losses. That's why you must be particularly wary of any company which "guarantees" profit or certain success. If you hear a claim about a company that sounds too good to be true, validate it with the franchisees. Investigate of all earnings claims made by a franchisor with the franchisees. But, regardless of earnings claims, you must recognize that your success can come only through hard work. Success or failure ultimately depends on you.

19. What are some of the drawbacks of owning a franchise?

In exchange for the security, training, and marketing power of the franchise trademark, you must be able and willing to give up some of your independence. If you are a person who likes to make most decisions on your own or to chart the course of your business alone, a franchise may not be right for you. As a franchise owner, you must comply with the various controls and procedures established by the franchisor. Then, too, all successful businesses require a lot of dedication and plain, hard work. You must be prepared to make that commitment.

20. Why should I be concerned whether a company is a member of the international franchise association?

Companies that belong to IFA must meet certain membership requirements. They must have a satisfactory financial condition and comply with all applicable franchise laws. In addition, all members must agree to abide by the Code of Ethics. IFA members are kept abreast of every change in franchising laws. IFA provides continuing educational programs for members on how to conduct their businesses. They receive the latest information about topics such as improving relationships with franchisees, use of technology, public relations, marketing, advertising, field operations, networking and things a company with an eye to the future must know and implement to compete in the marketplace. IFA members are committed to the future . . . to learning . . . to succeeding.

21. Are there any current trends in franchising?

Among the most important trends in franchising today are the internationalization of franchising, the emergence of women and minorities in franchising, and the increased use of technology. All of these have profound and positive effects on franchising and make it an even more dynamic method of doing business today.

International Franchising

- a. Franchised businesses continue to grow in all corners of the world. On average 14 percent of a country's franchisors establish franchises across borders. For instance, from 1985-1995, 48 percent of the units established by U.S. franchisors were international units. In 1995, more than 400 U.S. franchise systems operated internationally. In 2000, approximately 100 additional U.S. franchise systems set up globally. International franchising has been successful because consumers around the world recognize famous brands as symbols of quality, consistency, service, and value.
- b. If you are considering the purchase of a franchise, you may want to not limit the scope of your search to franchisors in your home country. Increasingly, franchisors are seeking franchisees internationally, and a foreign-based franchisor may provide you with the franchised opportunity that you are seeking.
- c. In many cases, foreign-based franchisors offer individual franchises to operate a single unit. They also often offer development rights to operate multiple units and "master franchise" rights. The latter is, essentially, an opportunity to be the "franchisor" for the foreign-based concept in your country or a portion of your country.
- d. Of course, international franchising presents different challenges than domestic franchising. For example, if goods will come from overseas, you may need to be aware of various duties, tariffs, and transportation requirements. You also need to consider language and cultural differences. For instance, if you are a franchisee in a different country from the franchisor's home office, the franchisor's system may need to be modified for use in your country.

Minorities and Women in Franchising

- a. Increasing numbers of minorities and women are discovering that franchising can be a good opportunity for everybody. While franchising is not a panacea, it provides a means for mitigating the traditional obstacles that otherwise competent and capable small investors, particularly women and minorities, face: lack of business experience and capital. Franchisors provide managerial training and assistance on an on-going basis and, in some cases, arrange for property leases, provide equipment financing and sale-leaseback programs, and assist franchisees in obtaining financing.

- b. As a result of a strong economy, women are increasingly in leadership positions in franchising whether through establishing new companies, becoming single and multi-unit franchisees, or having high-level positions at corporate headquarters.
- c. According to the National Foundation for Women Business Owners, 9.1 million women owned business firms in the U.S. This represented 38 percent of all business, employing over 27.5 million people, and generating over 3.6 trillion in sales.
- d. As the population of minorities in the U.S. continues to rise, minority franchising in cities is expected to rise.
- e. In addition, some governmental agencies encourage the franchising route for minorities, through programs such as Maryland's Equity Participation Investment Program.
- f. The Women's Franchise Committee (WFC) of the IFA which was formed in 1996, serves as a resource for women seeking career growth opportunities in franchising and provides international network opportunities, an annual meeting, and monthly telephone conferences.

Technology and Franchising

There are several trends related to the use of technology in franchising today.

- 1), many franchisors use the internet to communicate with franchise owners and suppliers through secure extranets in order to share critical information, facilitate discussion among the franchise network, post operations manuals and updates, disseminate news about ad campaigns, engage in supply chain management, and gather sales reports automatically and without the need for more labor-intensive data entry.
- 2), franchisors use the internet to advertise their network to customers.
- 3), some franchisors use the internet to engage in business-to-consumer (B2C) e-commerce, often with the involvement of franchisees.
- 4), many prospective franchisees glean information and make contact with franchisors using the internet. Some franchisors now report that they get more sales leads from the internet than from any other source.
- 5), and finally, franchisors make extensive use of technology in offering their services directly to consumers -- such as networks of businesses that offer website design and web hosting. The prospects for, and reality of, involving technology in franchising make this a very exciting time to own a franchised business.

For More Information

- **LEARN about FRANCHISING for FREE through the Official IFA Course on Franchising at <http://www.ifa-university.com>**
- **For Opportunities, Resources and Guidance about Franchising visit the IFA at www.franchise.org or call 202-628-8000**
- **Contact The Entrepreneur's Source at <http://www.FranchiseSearch.com>**

The Entrepreneur's Source is the nation's premier source for self-employment options, franchising information, education and training. The company is the first place to go for straight talk about franchise and other business opportunities, with no obligation or risk.

The International Franchise Association, the "voice of franchising", is the world's oldest and largest association representing franchising with more than 30,000 franchisor, franchisee and supplier members. The IFA's mission is to protect, enhance and promote franchising