

Nicola Broadhurst, head of franchising at Munday's looks at franchising for established franchisors

LOOKING BEYOND THE EARLY YEARS

After the initial successes and the inevitable problems of the first few years, the franchisor should be able to settle into a more steady growth pattern and concentrate on establishing a mature national network that will enhance the brand and give it the opportunity to reap the rewards of the hard work.

However, with a mature network and few, if any, new domestic territories remaining for prospective franchisees, there are other issues that need to be considered to ensure the business remains dynamic and continues to develop to its full potential.

It is also prudent for the franchisor to consider an exit route, both for itself and its franchisees, at the outset and work towards achieving these objectives.

Resales

For a franchisee, the most obvious exit route is the sale of his franchise business. This hopefully allows him to recover his initial investment with a significant profit. For a franchisor with a mature network, this is the only way of encouraging new enthusiastic franchisees into the organization.

As the sale of a franchised business as a going concern will call for a greater investment than a greenfield site, a different type of franchisee will be attracted which in itself will call for a different franchisee profile.

A resale of a franchised unit is a sale of a commercial business and, therefore, all the usual considerations that would apply to a conventional transaction would equally apply to the resale. It is, therefore, essential that both parties take proper legal and accountancy advice on the best way to proceed, and that the buyer carries out adequate due diligence.

In order to ensure that a franchisee is able to take advantage of this exit route, he should always check the franchise agreement at the outset. Most agreements (and certainly those drafted in line with the BFA code of ethics) grant the franchisee the ability to sell his business, but only with the franchisor's prior consent, which is usually given, subject to various conditions relating to the suitability of the prospective purchaser.

It is not unreasonable to impose this restriction on a franchisee's right to sell. After all, the franchisor will have to continue a relationship with the buyer after the sale and, therefore, it must be satisfied that the buyer is up to the job and satisfies all the current recruitment criteria.

It is also a usual condition that the franchisor is reimbursed for all its costs and expenses in investigating and training the buyer, but these costs should be reasonable and investigated with care at the outset.

A buyer should not be charged the full amount of the initial fee as many of the costs that make up the fee will not apply, such as that for the initial stock, or equipment. Only those costs which are necessary at the resale stage, such as training, should be charged.

In addition to these costs, most franchisors also take a percentage of the sale proceeds where they have been instrumental in introducing the purchaser. This is usually between 5-10 per cent. Again, this is not unreasonable if the franchisor has acted in a similar capacity to a resale agent by marketing the business for sale internally to the network, or externally to prospective new franchisees.

This, however, is not always the case and often a franchisor takes this commission for very little effort, leaving the franchisee, who must obtain the requisite consent, to sell with little room in which to argue.

For those franchisors with few or no new territories available, it is advisable to have in place a carefully monitored resale procedure with tailored sale documentation that is fair and reasonable to both seller and buyer for use by the outgoing franchisees.

This helps to streamline the process and keep costs down that could otherwise deter a prospective franchisee. This is clearly for the benefit of the network as a whole, and many established franchisors have such systems in place.

Franchisor's right to sell

A franchisor's main exit route is clearly to sell the business, either to a third party, or the existing management team. Most franchise agreements give the franchisor the ability to transfer them without the consent of its franchisees. Even with this right, however, the process must be handled with care.

A prospective buyer will not willingly wish to acquire disgruntled franchisees and usually some prior consultation is required. It is also worth noting that the assignment of a contract without consent merely transfers the benefit of that contract (i.e. the right to receive the fees, but not the burden, i.e. the franchisor's obligations to provide support and services). These cannot be easily transferred without the consent of the franchisee and unless the agreement has been clearly drafted to provide for this, the franchisee will need to be involved.

The prospect of ending up with a new franchisor, or new management, is surprisingly not one that is often considered by franchisees at the outset, but it does happen. Thus, it is essential that any representations that have been made by the franchisor and are not in the franchise agreement are evidenced in writing at the beginning so that any acquiring franchisor will be bound by them.

For other franchisors, the sale of the business is not an option they wish to consider, or certainly not in the immediate future. Instead they may choose to maximize the value of the business by expanding it as much as possible. This invariably means internationally.

International expansion

When a franchisor's network is nearing capacity in its home market, the business has three choices, assuming the plan is for continued growth.

The first is to launch a second franchise system at home; the second is to acquire the master rights for an overseas system (or acquire another existing UK franchised business); and the third is to take the existing system overseas.

Going international sounds exciting, but like all business decisions it needs to be carefully researched and planned. Cross-border franchising is, of course, not new and those who practice it have established some clear principles for success.

Be very clear about why you are going down this route, and what you expect to get out of it. Also be very clear that it will take a lot longer and cost a lot more than you think, but if your vision is to develop a global brand then it is very difficult to see how it can be done other than by franchising.

Start by putting together a detailed plan with a clear vision and objectives, and a detailed action plan with financial forecasts.

Be very clear about which countries you want to go to, and which are the priorities. Many factors will influence this decision, but the primary one is whether or not there is potential there for your product or service.

Sometimes the biggest potential markets (the U.S., India, and China) have specific legal or operational difficulties associated with them, or they are simply too far away for a first step, and it may be best to start nearer home. It is very common for UK businesses to start their international expansion by going to Ireland and Holland, which share the advantages of speaking our language and being nearby, the latter making it easier to ship goods and arrange visits.

Be very clear about the best entry strategy for each market.

Will you either set-up a subsidiary in the target country to sub-franchise; take on a master franchisee to do it for you; or appoint a developer capable of opening and operating its own chain of stores without sub-franchisees? Each method has its advantages, and you may end up with examples of all three, each the optimum for its own market.

Having worked out how to operate in a country, it is important to have a clear idea of who your potential partner may be. No doubt you have a defined franchisee profile for your domestic franchisees - the principles of developing this are the same, for overseas partners but, of course, their required knowledge, skills and attitudes will be very different. Running a store is not the same as developing and managing a franchised network.

Be clear about who on your staff is going to manage your international activity. It needs to be someone's job, not just an add-on to everything else they do in the parent business. You may need to consider appointing an experienced international franchise manager, even if only on an interim basis to get things going, and this is another investment which needs to be funded.

The selection of your overseas partner is critical, and this is no time for just taking the money from someone who wants to go ahead. A structured selection process will soon weed out those who are not suitable.

Those who are suitable will be able to present you with their own business plan for their market, clearly showing how they will exploit the opportunity, and how they will provide the financial and human resources to do so. You must arrange your own local due diligence to ensure your potential partner is indeed who it says

it is and has the capabilities to make the business successful.

Training is essential, both in how to operate the outlets and how to subsequently recruit and support franchisees (if sub-franchising is involved). Much of the initial training for management will be done in your home country, but there will also need to be some on-site support, particularly for the first few openings.

In due course, sub-franchisees or outlet staff will be trained in their own country by the overseas partner, so some-one will need to arrange translation of manuals and training materials. Make sure its clear who is responsible for the quality and cost of doing this.

Once there are outlets operating in an overseas market you will want to monitor their performance and, indeed, that of your master franchisee if it has a recruitment schedule to meet. This is easy to do if it is relatively close, but can you (or your franchisee) afford to pay for your trips to, say, Australia every few months? In many countries it is now possible to outsource some of this activity to local franchise consultants.

Of course, none of this is worth doing unless you will eventually make a profit, and you must again be very clear about how the money will flow through to you.

What will you charge upfront (country fee, exclusivity fee, training fee), what ongoing fees will you charge (royalties, store opening fees, mark-up on products, marketing fees)? What are the tax and currency exchange implications and what will you do if you don't get paid on time?

Successful international franchisors now know all the answers to these questions, but they got them by expensive trial and error. The benefit for businesses which are now starting their international development is that all this valuable knowledge is available to them through experienced advisers, like those in my own firm, and it is folly not to use them.

Franchiseworld Mar 2006