

# Identify the Advantages and Disadvantages of Owning a Franchise

**Y**OU HAVE PROBABLY VISITED many franchises. Your consumer experiences are apt to be rich. You may, however, be out of touch with the business model used by franchises. In a franchise, nothing is done by accident. Every product and service is carefully crafted to be the same from one location to the next.



## Objective:



Describe franchise ownership as well as its advantages and disadvantages.

## Key Terms:



- advertising fee
- franchise
- franchisee
- franchisor
- initial franchise fee
- royalty fee

## Owning a Franchise

The overwhelming majority of U.S. citizens are familiar with McDonald's, Subway, and Jiffy Lube and their products or services. Do you know how many of these businesses are located in your geographic area? Have you ever worked at one of these businesses? What is required to start one of these businesses?

## FRANCHISE OWNERSHIP

---

### Franchise

A **franchise** is a legal agreement that gives an individual the right to market a company's products or services in a particular area. The franchise is a well-established business model with a long, successful history.

### Franchisee and Franchisor

The **franchisee** is the individual who purchases a franchise agreement. The **franchisor** is the person or company offering a franchise for purchase. The **initial franchise fee** is a fee paid by the franchisee in return for the right to run the franchise. The initial franchise fee is an initial check you write to the franchisor when you sign your franchise agreement. It is the cost of joining the franchise system. It is usually a fairly large flat fee.

### Royalty Fee

A **royalty fee** usually involves weekly or monthly payments (or another regular schedule) made by the franchisee to the seller of the franchise. It is the principal fee in franchising, other than the franchise fee. In some systems, it is known as the continuing royalty. It refers to the checks you send to your franchisor on a routine basis throughout the term of the agreement. You make this payment for the right to remain part of the franchise system. While it varies from franchisor to franchisor, the royalty is typically calculated as a percentage of your sales.

Many franchisors today do not require a physical check payment from the owner. When you sign the franchise agreement, you may give them permission to reach into your checking account and wire transfer the payment directly to them.

### Advertising Fee

The **advertising fee** is advertising costs, as directed by the franchisor. It may be an expense included in the franchise agreement.

## ADVANTAGES OF FRANCHISE OWNERSHIP

---

Some people choose franchise ownership because of its many advantages, such as experience, branding, support, leveraging, security, self-employment, the respected business model, and reduced risk.

### Experience

You gain the benefit of a franchisor's experience and knowledge, which reduces the possibility of multiple business mistakes. In particular, franchisees are spared many of the administrative headaches associated with setting up a new business. Many studies and experiments have already been conducted. Therefore, as a franchise owner, you are able to take all the best practices and use them from the beginning. Your learning curve is very short.

## Branding

In many cases, the franchisee has the advantage of the brand name and reputation established by the franchisor. Establishing a brand can be costly in terms of time and money, so using a previously established brand is extremely valuable.

## Support

The franchisor may offer training and ongoing support within the package. Such assistance allows for a quick learning curve and the ability to glean the latest and greatest methods of doing business.

## Leveraging

The franchisee may benefit from many of the franchisor's activities (e.g., advertising, marketing, research, and development) and may have the additional advantage of enhanced buying power. Basically, the franchisee is allowed the benefit of being a small business with a big brother ready to jump in as needed. The franchisor uses its larger resources to assist with services that the small franchise cannot afford, in terms of time, money, or people power.

## Security

A market-tested and structured franchise system—from a competent franchisor—offers the franchisee more of a safety net than going into business independently.

## Self-Employment

As with any form of self-employment, the franchisee would be working for his or her future and not someone else's. You are your own boss as a franchise owner.



## BROADENING AWARENESS...

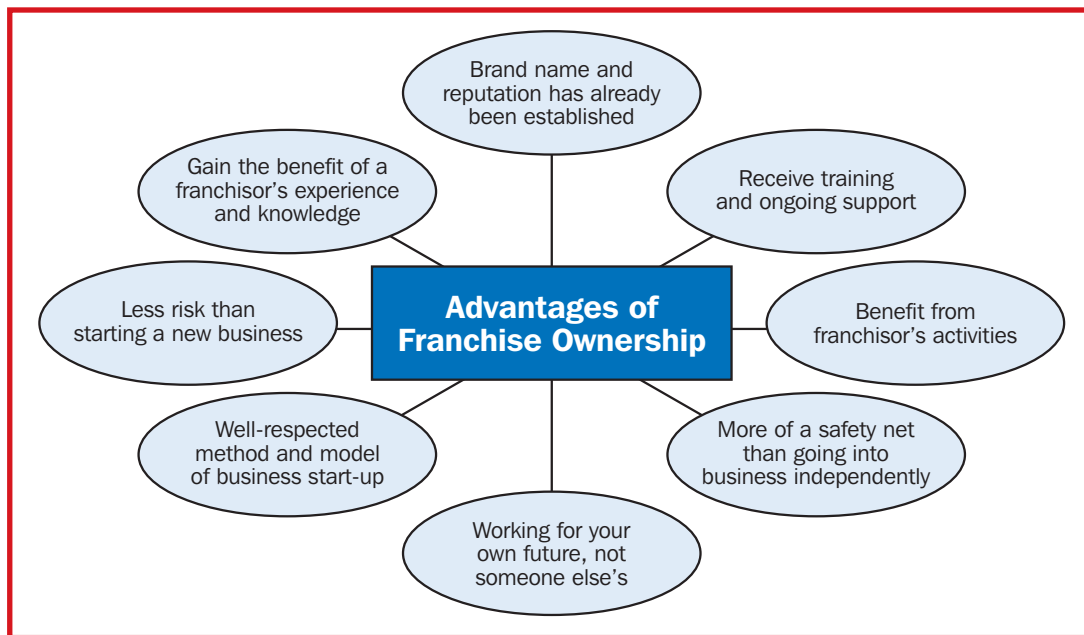
### AMAZING ASPECTS:

### Top 50 Franchise Opportunities for 2010

When most people hear the word franchise, they immediately think of fast-food chains: Panera, McDonald's, Wendy's, Subway, Pizza Hut, and countless others. However, there is an extensive list of franchise opportunities outside of fast food. Visit the following link and review the list of opportunities:

<http://topfranchises.franchisebusinessreview.com/index.php>

The Web site is organized by start-up fees, type of franchise, and best in category. Pretend that you have \$40,000 to invest. What franchise opportunity would you pick and why?



**FIGURE 1.** Advantages of franchise ownership.

### **Well-Respected Business Model**

A franchise is a well-respected method and model of a start-up business. The franchise model has a rich U.S. history and a bright future.

### **Less Risk**

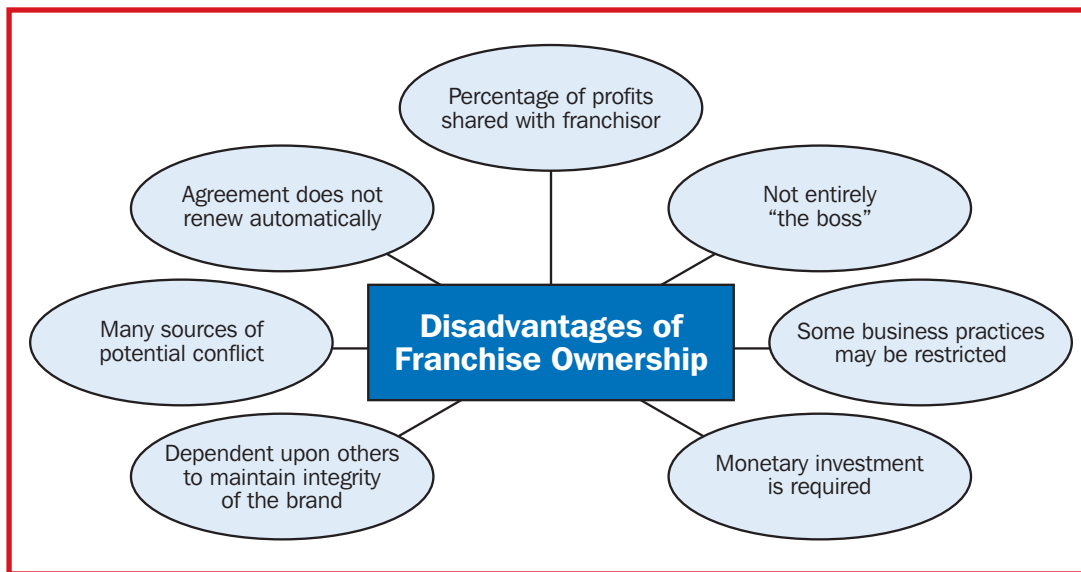
Some may believe there to be less risk with buying into an existing and proven business or franchise than in starting a new business from square one. Banks, for example, may perceive a franchise investment as a lower risk than other new start-up businesses.

## **DISADVANTAGES OF FRANCHISE OWNERSHIP**

The franchise business model has many advantages. But no model is without costs, risks, and limitations.

### **Costs**

The most obvious difference and disadvantage of the franchise model is that a percentage of the profits must be shared with the franchisor. This is non-negotiable. In addition, while the franchisee is clearly the captain of the team, the franchisee is not entirely “the boss.” The franchisor is the undisputed coach of the team and what he or she says is the rule. This can be difficult sometimes and may require extra work or burden for the franchisee. Related to this idea, some business practices may be restricted by the franchisor (e.g., choice of suppliers, employment policies, customer base, and territory).



**FIGURE 2. Disadvantages of franchise ownership.**

## Risks

Another disadvantage is that a monetary investment is required. In other words, cash or a loan is needed up front to begin, which is not always feasible for every person who desires to go into business.

The franchisee is dependent upon the franchisor and other franchisees to maintain the brand's integrity. One bad apple could adversely affect the whole network. This is somewhat risky because people will carry the feelings they have for the brand from store to store.

## Limitations

Franchising is a complex area with many sources of potential conflict between the franchisor and franchisee, particularly regarding the terms of the contract. When a franchise agreement expires, it does not renew automatically. It is in the best interest of both parties to perform in a way that makes the other successful. This is the most desired partnership dynamic.

## Summary:



A franchise is a legal agreement that gives an individual the right to market a company's products or services in a particular area. The franchise is a well-established business model with a long, successful history. The franchisee is the individual who purchases a franchise agreement from the franchisor. The initial franchise fee is a fee paid by the franchisee in return for the right to run the franchise. Regular royalty fees are also paid by the franchisee.

There are many advantages to franchise ownership including, but not limited to, the benefit of a franchisor's experience and knowledge, the advantage of the brand name and reputation, the ongoing support, and the ability to leverage.

Some of the disadvantages of the franchise model are that a percentage of the profits must be shared with the franchisor. Also, while the franchisee is clearly the captain of the team, the franchisee is not entirely “the boss.” The franchisor is the undisputed coach of the team, and what he or she says is the rule. This can be difficult sometimes and may require extra work or burden for the franchisee. Another disadvantage is the monetary investment required. The investment can be hefty. It is an advantage and a disadvantage to have a larger, controlling partner in the business of owning a franchise.

## Checking Your Knowledge:



1. List three advantages of buying an existing business.
2. List two disadvantages of buying an existing business.
3. Explain what happens when a franchise agreement expires.
4. Define the meaning of the “initial franchising fee.”
5. Describe some of the limitations of owning a franchise.

## Expanding Your Knowledge:



Use the Internet to research one specific U.S. franchise of interest to you. Determine the advantages and disadvantages of owning that particular franchise. Present your findings to your class in a PowerPoint presentation.

## Web Links:



### Franchise Fee Made Simple

<http://www.entrepreneur.com/franchises/franchiseexpertsarchive/article51174.html>

### Advantages and Disadvantages of Owning a Franchise

<http://www.evancarmichael.com/Buying-A-Business/914/Advantages—Disadvantages-of-Owning-a-Franchise.html>

### Franchise This!—Franchising Your Business

<http://www.franchisethis.com/faq7.asp>

### Franchise Tips

<http://www.buyingafranchise.org/franchise-tips>

### Top Franchise Opportunities

<http://topfranchises.franchisebusinessreview.com/?gclid=COeCsr23zqICFQ855wodvExdzQ>