

# Frequently asked question when you considering purchasing a franchise

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## What is franchising?

The word “franchise” in French means “privilege” or “freedom” – in essence giving an individual the “right” to something – in this case the right to operate a business or licence under specific conditions.

Franchising is, without doubt, the most “public” of business formats. You recognise a franchise because it carries a strong brand, has a distribution mechanism that reaches far and wide and provides a uniform product, service and image to the public. The word franchising, however, can apply to many “rights” – from the franchising rights of cartoon characters like Mickey Mouse or movies like The Matrix to the franchise “rights” of soccer clubs like Ajax.

Business format franchising is defined as a distribution network operating under the shared trademark or trade name with franchisees paying the franchisor for the right to do business under that name for a specified period of time. In exchange, the franchisee is able to use the franchisor’s business system or format, including the name, goodwill, product and services, operating manuals and standards, marketing procedures, systems and support facilities. The franchisor, in turn, is obliged to give initial and ongoing services and support.

Product & trade name franchising is characterized as a sales relationship between a supplier and a dealer, product and trade name franchises can be found most commonly in car dealerships, petrol service stations and cold drink bottlers. The dealer is granted the right to sell its products in exchange for fees and royalties and has an obligation to sell only the franchisor’s products.

## Get the facts on franchising

On a more basic level, franchising is really just an extremely good distribution method. The “franchisor” or person, who starts a company or develops a concept, uses others (franchisees) to duplicate his concept and distribute it on a large scale. This inter-dependency forms the basis to the business format and its success lies in the effective implementation of certain basic but clearly defined business principles. The juxtaposed relationship between franchisor and franchisee needs to be fully understood and accepted for the overall business to succeed. The responsibilities of each side include:

### THE FRANCHISOR

- Is the originator of the concept
- Provides an established and tested business system
- Has an established name, brand and trade mark
- Sells “clones” of his concept in order to grow the business and build the brand
- Supplies the know-how, training and support services
- Expands his network rapidly and cost-effectively
- Benefits from pooled operational efficiencies

### THE FRANCHISEE

- Buys a ready-made business package
- Buys the rights to operate under a well-established brand name
- Invests capital, time and effort to replicate a proven concept
- Must follow the franchisor’s standards, methods, procedures, techniques & marketing plans
- Must pay a fee to the franchisor for the rights to use the trade mark and business systems for an agreed period of time.
- Benefits from skills transfer, training and business support
- Invests in a viable business that will prove to be a good investment.

Changing a career path is a momentous step and deciding to invest in a franchise business needs to be taken seriously. Jumping into self-employment with the first franchise that takes your fancy is not a wise move. Spending time investigating the franchise sector, what's on offer and how the various companies are structured is crucial to making the right decision.

### **REVIEW THE SECTORS**

Unless you know exactly what type of business you want to get involved in you need to become familiar with the many sectors that make up the franchise industry in South Africa. Don't dismiss any sector before investigating fully – you might be surprised at the hidden opportunities.

### **COMPARE FRANCHISES WITHIN A SECTOR**

Study the offerings of different companies within a sector. Make notes on their similarities and their differences and ask questions on why they may differ in various aspects – be they financial or operational. You should pick up discrepancies or shortfalls that may alert you to any inadequacies.

### **CHECK OUT THEIR FASA STATUS**

One of the first questions you need to ask is "Are you a member of the Franchise Association of South Africa? And if not, why not? Remember that the process required to become a member of FASA is quite onerous and franchise companies that make the effort to comply with FASA's stringent code of ethics are more transparent operators with sound business principles.

### **CHECK OUT THEIR CREDENTIALS**

Don't take anything at face value. Investigate the company's history, find out who owns it and scrutinize their Disclosure Document. Question anything that strikes you as being out of the ordinary and ask for referrals from their business associates and suppliers.'

### **UNDERSTAND WHAT MAKES UP A FRANCHISE PACKAGE**

Knowing what you would be in for is important at the outset and familiarizing yourself with what makes up a turn-key operation will give you a head-start when you start evaluating each opportunity. Understand what makes up the up-front fee, the set-up costs, the management fees and look for any unforeseen expenses.

### **CRUNCHING THE NUMBERS**

Even before embarking on your own Business Plan, get an accountant you trust you look at the projected income figures of the franchises you are interested in to make sure they are realistic. Look for all the other costs that will affect the bottom line like advertising contributions, training fees and the unencumbered cash that is required to tie you over until you become profitable.

### **REVIEW FINANCING OPTIONS**

Even if you are in a position to self-fund your business venture, consult with all the banks that have franchise divisions and get their insight into which franchises they have audited, finance and support. Then ask their opinion on the best way to raise the funds to finance your business. Their close involvement with the franchise sector will be invaluable in guiding you to making the right choices.

### **UNDERSTAND THE LEGALITIES**

The core of franchising lies in the rights and obligations of both parties and understanding the legalities of what you are getting involved with is perhaps the most crucial element to choosing the franchise route. Once you've made your choice you need to consult with a lawyer who has experience in franchising to make sure that the franchise contract is fair to both parties.

### **TAKE A LONG-TERM VIEW**

This goes for yourself and the franchise you are planning to invest in. When assessing a franchise, look at their history and their long-term prognosis and match that with your own plans of investing in a solid franchise that will see you in business for a few years to come

### **THE PROS**

- **Buying into a proven turn-key operation**  
The advantage of buying a turn-key business with an established brand and tried and tested operational procedures is probably the most important advantage to investing in a franchise.
- **Reduction of risk**  
Whilst it is not an absolute given, the very fact that only 20% of franchises fail compared to the standard norm of 80% of independent businesses, it is safe to say that buying into a franchise system is less risky as you are buying into an established concept with proven operating standards.
- **Start-up assistant**  
From the moment you sign on the dotted line, the franchisor will take you under his wing and provide all the necessary set-up support - from site selection to fitting and stocking up the store as well as training and marketing support.
- **On-going support**  
On-going support in all aspects of operations will be given based on group bench-marking and sound business principles. This is usually linked to operations, quality control and marketing and appropriate feedback is given to improve all-round performance in accordance with group norms.
- **Group Benefits**  
The benefit of belonging to a family of franchisees is extensive – from getting preferential financing through the strength of the brand to benefiting from bulk buying; from enjoying the fruits of new product innovation to reaping the results of pooled marketing resources.
- **Being part of an established brand**  
As an independent business, you would never be able to benefit from the knock-on effect of being aligned to a well-known brand. The benefits of joint advertising maximize brand awareness and increase the profile of each and every franchisee in the group.

### **THE CONS**

- **High cost of the franchise**  
The cost of buying into a franchise is relatively high to setting up an independent business as there are no short-cuts – you need to follow the franchisor's blueprint and that means adhering to certain minimum standards of furnishings, fittings and equipment.
- **Ongoing royalty or management fees**  
For the right to use the intellectual property and in order to benefit from the on-going operational and marketing support, you will need to factor in a percentage of your turnover being paid over to the franchisor on a monthly basis.
- **Rigid Operating Procedures**  
In order to maintain conformity of brand and the replication of the proven formula you will need to run the business according to the strict rules of the Operations Manual which will become your 'bible' on how to operate the business.
- **Loss of Freedom**  
Since the franchisor's standards have to be followed stringently with no room for individual initiative, the loss of control and freedom to do things your way could be seen as a disadvantage.
- **Sale Restrictions**  
Where an independent operator is free to sell his business whenever he wants and to whomever he chooses, in franchising, the sale of a franchisee's business is always subject to the approval by the franchisor of the suitability of the purchaser of your business.
- **Bad franchise operator**  
Although it doesn't happen very often, there is the risk that the franchisor, through bad judgement, greed or miss-reading of the market, mismanages the franchise and this could impact on the franchisees that are then left high and dry.

Franchising is not for everyone or the faint-hearted and there are the negatives – from whether you are suited to franchising to the controls that the franchisor imposes on your business. Although most franchisees have an element of entrepreneurship inherent in them, most are former employees, from corporate backgrounds, or are the victims of mergers or downsizing, or are on the verge of retirement.

### **ON A PERSONAL LEVEL YOU SHOULD ASK YOURSELF THE FOLLOWING QUESTIONS**

- Are you generally a healthy person?
- Are you a confident, outgoing type of person that is not afraid of tackling challenges and problems head-on?
- Are you a people-orientated person, able to interact with people on all levels?
- Are you the type of person that can handle stressful situations, are comfortable with taking risks and are prepared for a total change in your lifestyle?
- Are you in a position to support yourself through the initial stages of setting up a business?
- Do you have enough qualifications or experience to handle things like managing finances, doing sales and marketing?
- Are you customer service orientated?
- Are you the type of person who takes direction willingly or are you known as a “buck-the-system” type of person?
- Do you like and enjoy people in general?
- Can you lead and manage people?
- Do you have the support of your family?
- What do you like to do?
- What are your interests and what type of occupation would be most compatible with those interests?
- Do you think you will enjoy operating your business of choice?

According to Eric Parker and Kurt Illetschko, authors of the book **Franchising in South Africa: The Real Story**, investing in a franchise is a long-term commitment that, once made, is extremely difficult (and expensive to reverse). Franchise experts like to compare entering in a franchise arrangement with a marriage. The honeymoon is the easy part but it does not last very long. Once the novelty has worn off, making the best of the relationship can be a grind but many endure, and decades later, would not want to have it any other way. These two franchise experts suggest you ask yourself the following questions....

### **AM I CUT OUT FOR ENTREPRENEURSHIP?**

To be successful in a business of your own requires an entrepreneurial spirit. Although joining a franchise eases you into your new role, it does not do away with this requirement altogether. A carefully chosen franchise offers you a blueprint to business success but there are no guarantees. A franchisor that offers a franchise complete with success guarantee is either a fraud or a fool. A prospective franchisee who relies on such a guarantee is simply a fool.

### **WILL I BE HAPPY AS A FRANCHISEE?**

In a franchise, you own the infrastructure of the business but you cannot do as you please. To protect the brand, the franchisor is obliged to insist that you operate in accordance with the network's rules. Some people find this too restrictive.

### **DO I HAVE THE NECESSARY PASSION?**

People often say that their sole reason for wanting to start a business is to make lots of money. They pretend not to care about the sector but in reality, this does not work too well. Starting a business is hard work, and it takes some time before you see any rewards. Unless you enjoy what you do, the business will soon become a burden and success is likely to elude you.

### **IS A FRANCHISE AVAILABLE IN THIS SECTOR?**

It has been said that almost any business can be franchised. While this is probably true, it is only of academic interest to you. What you need to find is a franchisor who is well established in the field of your choice and able to deliver on the promise of franchising. Otherwise, why bother paying franchise fees>

### **IS THE FRANCHISOR RESPONSIVE?**

Although a large number of franchise systems exist, the better known brands continue to operate in a sellers' market. Many networks, especially those in food and retail, battle to locate good sites and this tends to slow down their expansion plans. Never mind the reasons, unless the franchisor shows interest in your approach, move on. If the franchisor neglects you during the courting stage, what will happen once you are part of the network?

### **IS THE FRANCHISOR'S APPROACH PROFESSIONAL?**

Acceptable premises, membership of FASA, professionally produced franchise materials and the availability of a formal disclosure document indicate that the franchise operates to sound professional standards. A good franchisor will insist on checking you out but knows that this should be a two-way street. The franchisor will welcome your questions, in fact, most love to talk about their achievements and the standing of their brand. Should you come across a franchisor whose representative is reluctant to provide essential information or, worse still, attempts to pressurize you into making a rush decision, terminate negotiations immediately. Responsible franchisors do not act in this way.

### **ARE WE COMPATIBLE?**

When you visit the franchisor and get to know the network's team, do you feel like an outsider, or do you fit right in? Unless there is an instant spark, it is unlikely to work.

### **CAN I AFFORD THE FRANCHISE?**

The financial implications of becoming a franchisee are manifold. You need to pay an upfront fee, fund the establishment of your business and provide working capital. On an ongoing basis, you also need to provide working capital, pay periodic franchise fees and make provision for living expenses. Keep in mind that it can take several months or even longer before the cash flow of the business is sufficiently strong to cover expenses. Many finance schemes are available but this is not necessarily a good thing. Most franchisors will insist that you fund between 30 –50% of the complete investment from your own resources, with good reason. Loans need to be repaid on time and with interest. If borrowings are excessive, the resulting repayments would place strain on your new business's cash flow. This could force the business into a cash flow crisis and cause it to fail.

### **CAN THE FRANCHISE AFFORD ME?**

This is another important consideration. As this is your own business, you can determine your salary – on paper. In practice, the business may not be able to support the lifestyle you and your family have become accustomed to, especially if you held a senior position in a large corporation. Of course, a few years down the line, the situation should change but you need to survive the here and now.

**(Extract from FNB's Franchising in South Africa: The Real Story by Eric Parker & Kurt Illetschko)**

## Credits

Fasa Website: [www.fasa.co.za](http://www.fasa.co.za) – Guidelines

FNB's Franchising in South Africa: The Real Story by Eric Parker & Kurt Illetschko

## More Details & Contact

For more information or any other questions please feel free to contact

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