

FRANCHISOR OR FRANCHISEE?

By Andreas Hadjipavlou

FEW CYPRIOT COMPANIES HAVE REACHED SUFFICIENTLY HIGH LEVELS OF BRANDING OR DEVELOPED AN APPROPRIATE BUSINESS MODEL TO BE ABLE TO ATTRACT INTERNATIONAL FRANCHISEES. This looks set to change over the next two to three years, however, with several Cypriot companies preparing to enter the European market as franchisors. By contrast, many successful franchises are being operated by Cypriot entrepreneurs throughout the island. For those who are still apprehensive about their potential as franchisors or franchisees, IN Business International offers the following hints and tips that can lead to a successful franchise business.

LET'S START BY GETTING THE DEFINITIONS OUT OF THE WAY: a franchise is a licence granted by one business (the franchisor) to another (the franchisee), which entitles the franchisee to operate under the franchisor's trademark or trade name in return for payment. Examples of franchises exist on every high street and include all types of business, from international chains of fast food restaurants to regional networks of fitness centres.

Franchising is a popular method of growing a business with relatively low risk, requiring a reduced level of capital investment since it is up to the franchisees to invest their time and money in new outlets for your product or service. This method is gaining popularity worldwide, Cyprus included.

Businessmen here have always preferred the option of becoming franchisees rather than franchisors and, in those cases where they have become franchisors, they have tended to limit their activity to Cyprus. This is mainly due to practical reasons, as it is much easier for the franchisor to support Cypriot franchisees. Another reason is because it is much harder for a franchisor to attract franchisees from other parts of the world. The challenge for most Cypriot companies is that they have not developed an appropriate business model, nor have they reached sufficiently high levels of branding to be able to attract international franchisees. This looks set to change over the next two to three years, however, with several Cypriot companies preparing to enter the European market as franchisors.

A FORMULA FOR SUCCESS?

In a franchising relationship, the key advantage from the franchisee's perspective is that it allows him/her to be his/her own boss within the protective framework of a larger organisation and this can be a highly successful formula. However, it is not a soft option. A franchise requires just as much hard work and dedication as any other type of business if it is to become a success.

A good franchise can offer a head start by providing the franchisee with:

- A business model that has been thoroughly tried and tested by the franchisor and has been proven to work. If the franchisor's business model and guidelines are followed and the right level of commitment is applied, there is a good chance of creating a successful business.
- A faster start to trading, which can help greatly in minimising the time it takes to start generating a serious turnover.
- An established brand. This removes the necessity to work hard to create a new brand, which would be the case if the franchisee were to start his/her own independent business. Also, the franchisee will be provided with training and given access to marketing and advertising campaigns that would otherwise be beyond the scope of a small business.
- Help and advice on many different and varied business matters. Such support is readily available from a franchisor, whereas someone setting up their own business can easily be left out on a limb.
- Guaranteed quality control and standards.

Franchising works successfully with a wide variety of products and services, though not all businesses are suitable (a concept or an idea cannot be franchised). Successful franchising comes about when a business is already supplying a product or service with a broad market appeal or a specialist product or service for a niche market in which it already operates successful outlets. Such product or services have proven to be profitable and their brand has a high profile and/or a strong reputation.

So, is franchising a foolproof way of making money? Not necessarily. The franchising model is seen by some to pose a number of inherent disadvantages. For example, the franchisee is not entirely his/her own boss and how the business is run is often restricted when it comes to the choice of suppliers, employment policies, the customer base, the size of territory, etc. Also, if a franchisor goes out of business, the franchisees can be left with businesses that are not really viable as totally independent operations.

Another disadvantage is that a franchisee is dependent on the franchisor and other franchisees in the group to maintain the integrity of the brand. One bad franchisee can have an adverse affect on the whole network. Franchising can be very complex and there are many areas of potential argument between franchisor and franchisee, particularly with regard to the terms of the contract. It is the franchisor's duty, therefore, to maintain harmonious and positive relationships with each franchisee and across the whole network.

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STARTING UP

Establishing a successful franchise requires considerable thought and planning. A good way to start is to identify the elements of the business that will be transposed to each franchised outlet. The franchisor should have a good track record of operations within a particular market and be supported by friendly and effective business systems. This proven business model should be set out in an easy-to-implement Business Plan which, where appropriate, will also include manufacturing processes and distribution systems.

The franchisor will be expected to provide a protective framework for his franchisees by monitoring the quality and standards of the network as a whole. **These support services (the cost of which will be included in the fee) should include:**

Product and service development, promotion and public relations for the network, purchasing, financial and administration services for the network, communication between franchised outlets, discipline and Quality control, protection of intellectual property (such as brand names, patents, copyrights and trademarks) at home and abroad.

THE FRANCHISE AGREEMENT

The following should also be considered (and included) when drawing up a Franchise Agreement:

- The supplies and materials the franchisor will provide.
- The terms and amounts of the franchisee's payment for licences, management fees and other costs imposed by the franchisor.
- The duration and basis for any renewal of the agreement.
- The terms by which the franchisee may sell or otherwise transfer his/her interest in the franchise.
- The terms by which the franchisee may use the franchisor's trade names, brand names,

logos, store signs and service marks.

- The rights of the franchisor to adapt the franchise system to meet new or changing methods and market conditions.
- The rights of the franchisor to terminate the Franchise Agreement before the expiry of its full term (for example, if a franchisee fails to meet required standards).
- The ownership of property (both tangible and intangible) provided to the franchisee and the provisions for its surrender upon termination of the agreement.

The franchisor will benefit financially by making two charges: the franchise fee (an initial one-off payment for granting the licence) and an annual management fee for the support services provided. In addition to fees, the franchisor can also make money by reselling to franchisees the raw materials relating to the business.

It is accepted practice to keep the franchise fee as low as possible in order to attract good franchisees. Furthermore, the franchisor should ensure that the annual management fee represents value for money.

Most franchisors base their annual charges on a percentage of turnover, though it is not uncommon to levy the charge as a mark-up on the retail price of each product or service supplied by the franchisee.

Because franchisees invest their own time and money, they tend to be highly motivated individuals. However, this should not distract the franchisor from the fact that the franchise network will only succeed if franchisees of sufficient calibre are attracted. The vetting process needs to be thorough and the franchisor should be wary of associating with badly-run franchise recruiting agencies.

In order to attract interest from quality franchisees, the franchisor could consider:

- Advertising in newspapers, trade magazines or online.
- Franchise centres and brokers, though one needs to be careful about giving a finan-

cial incentive to third parties to recruit on one's behalf.

- Franchising exhibitions.

As part of any franchise package, a new franchisee will usually be given the company's franchise manual. Franchise manuals are generally linked to the company's Franchise Agreement and, as such, its contents should at all times remain strictly confidential. If the franchisee eventually decides to sell or give up the business, the franchise manual should always be returned to the franchisor. The agreement contains all the franchise company's trade secrets and operating systems and, for obvious reasons, should not fall into the hands of others outside of the scope of the franchise business.

HINTS AND TIPS FOR FRANCHISORS:

Research your subject fully. Specialist bodies provide excellent literature and training seminars for potential franchisors.

Be prepared to disclose details of your finances and business plans to your franchisees, as they will need to know this information.

Consider running a pilot operation in two or three different locations for at least twelve months.

Remember that you will need to commit a substantial amount of time and money to market research, to forming your network management team, and purchasing initial stock and equipment to ensure that your network is a success.

Don't underestimate your initial costs; you will need professional, specialised help and such advice is never cheap.

Don't overestimate early growth rates and don't assume that the franchise fee will produce profits. For most franchisors it is the annual management fee that produces real returns.