Advantages and Disadvantages of Franchising

Franchising is present in our daily lives and surrounds us wherever we go.

Businesses expand by franchising as way of accessing external capital to fund the growth of new stores or outlets that are operated by committed and profit-driven franchisees that are likely to be more diligent and focused than employed staff.

Franchisees are attracted to franchising for the prospect to become their own boss without re-inventing the wheel. The old adage “in business for yourself, but not by yourself” accurately describes this motivation.

Below is a summary table of advantages and disadvantages of becoming a franchisee. A more detailed explanation of each item is listed at the end of the table.

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### ADVANTAGES

**Advice and support from fellow franchisees**
- Potential often exists to grow beyond one outlet
- Franchisor establishes supply chain for network
- Franchising provides an opportunity for people to more easily get into business for themselves

### DISADVANTAGES

**Risk that fellow franchisees damage the brand, and indirectly, your business**
- Saturation in a mature market could result in encroachment by franchisor or other franchisees
- Franchisee may lack freedom of choice in suppliers
- Franchisor may receive rebates on franchisee purchases from suppliers
- The franchisor may select the wrong people as franchisees

### ADVANTAGES OF FRANCHISING

**Known set-up costs**

Based on their experience of operating their own outlets initially and subsequently after other franchisees have joined the network, a franchisor is likely to have a quite accurate estimation of the set-up costs of the business. By comparison, independent businesses that do not have the benefit of opening multiple outlets beforehand underestimate the set-up costs and risk compromising on key elements, such as working capital.

**Cashflow lending available from some banks**

A number of major Australian banks now have a process whereby they are able to establish a risk profile for a franchise brand which may allow the bank to reduce its dependence on traditional bricks and mortar security for a business loan, and instead place greater value on the business’ capacity to generate cash. Cashflow lending in this manner may be as high as 70% of the value of the business.

**Access to existing brand and operating systems**

A franchisee does not need to reinvent the small business wheel. Investing in a franchise will provide access to a brand that may be well-known and regarded, as well the ‘know-how’ needed to operate that business.

**Franchisor brand and support can reduce chances of business failure**

The strength of the brand and the guidance of the franchisor can create a more profound impact in a local market compared to a new independent business. This can help a franchisee achieve a higher level of performance sooner than a
comparable independent business, and in the long term, potentially reduce the chances of business failure for the franchisee.

**Customer awareness of brand, its products and services**

A new franchise may already have a high level of demand for its goods and services as a result of the profile of the brand in adjoining locations. Equally the products or services offered may be unique and distinctive and also have a high level of demand which can provide a franchisee with a running start compared to an independent business owner.

**Centrally organised marketing and brand promotions**

The franchisor generally provides marketing expertise for the network, and takes responsibility for organising group-wide marketing and promotional activity. Marketing is a core function of any business and one which many business owners are too busy elsewhere to undertake properly by themselves. Franchising allows this important function to be outsourced to the franchisor.

**Franchisee not required to be a marketing expert**

In addition to the lack of time a franchisee may have to devote to the marketing of their business, the franchisee is also able to benefit from the knowledge and experience of the franchisor in knowing what marketing and promotions activities will be more effective than others. This means a franchisee does not have to be an expert marketer in their own right, or hire one independently.

**Training in the operation of the business provided**

A franchisee may not need to have previously worked in the field in which they are operating their franchised business as they are trained by the franchisor. Many franchise systems do not require a specific qualification or work background to qualify for the franchise, and consequently a wider range of possibilities is open to a potential franchisee who can be trained in the operation of the business by the franchisor.

**Training for the franchisee’s staff**

Additionally, the franchisor may make training available to the staff of the franchisee, as well as the franchisee themselves. By training a franchisee’s staff, the franchisor can ensure greater consistency of frontline customer service standards, and alleviate the franchisee of the burden of conducting their own training.

**Franchisor may select site or territory**

Many people who go into business for themselves for the first time may have little or no experience in the analysis required to identify a viable location or territory. A
franchisor is likely to have developed significant experience in this regard over time and be quite proficient compared to an independent newcomer for whom the process may be more miss than hit.

**Ongoing advice, guidance and support from franchisor**

One of the most tangible elements of the franchise offer is the ongoing support, guidance and advice generally provided by a franchisor to the franchisee. This may be a combination of both structured and scheduled support, as well as ad hoc support made available according to a franchisee’s needs. The ability to refer to a senior business partner with “been there, done that” experience is highly valued by franchisees.

**Store or territory visits to support franchisees in the field**

An extension of the support and guidance provided by the franchisor is the in-store or territory field visits by the franchisor’s representative to provide on-site coaching, mentoring and training to a franchisee. Such support is simply not available in such a comprehensive and holistic manner to independent business operators.

**Advice and support from fellow franchisees**

Above and beyond the support of the franchisor is the advice and support provided by fellow franchisees. In joining a franchise network, a new business owner becomes a member of an exclusive group of peers who all operate similar businesses, face similar challenges, and can share and benefit from each other’s solutions. This type of support has many advantages that would otherwise not be available to a non-franchised business.

**Potential often exists to grow beyond one outlet**

Many franchise networks continue to grow and this can provide opportunities for successful franchisees to continue to expand as business owners into additional outlets or territories, subject to their own capacity and the nature of the business model of the franchise.

**Franchisor establishes supply chain for network**

An independent business owner must source their own products and services and can spend months or longer to find suppliers, whereas a franchise network has a pre-existing supply chain that a franchisee can plug straight into. In many cases, the franchisee does not need to waste valuable time and energy trying to find new suppliers, and can concentrate more quickly on other business priorities.
Franchising provides an opportunity for people to more easily get into business for themselves

Franchising can help lower the barriers to entry for people seeking to get into business for themselves because of the work done by the franchisor in establishing the system and providing the know-how and training to run the business. The franchisee does not have to re-invent the wheel in the way that an independent business operator would, and can start operating more proficiently more quickly with fewer potential obstacles than an independent operator (and of course, able to access the support of the franchisor during the process).

DISADVANTAGES OF FRANCHISING

Potentially higher set-up costs compared to independent small business

A franchised business may cost more to initially establish than an independent business. Additional costs not faced by independent business owners include the upfront franchisee fee (which is paid to access the franchisor's brand and know-how), and the training fee. Franchisors, based on their experience, may require a greater investment in fit-out, equipment, initial stock and marketing than an independent business operator might in the knowledge that such levels of initial expenditure establish long term competitive advantage over independent rivals.

Not all systems are accredited for cashflow lending

While some franchise brands are accredited by banks for cashflow lending services, many are not. It is estimated that of the approximately 1,100 franchise brands in Australia, less than 20% may have bank accreditation. For other systems, normal bank lending practices requiring high levels of real estate security are likely to apply, and this may be an obstacle to entry for potential business owners.

A franchise is for a limited time only

Few people realise that a franchise does not last forever. It is a conditional grant limited by time. The duration (or term) of a franchise agreement will vary from one system to another, but has been found by the Franchising Australia survey to be five years on average. This means that toward the end of the five year term, a franchisee may be offered another term under a new franchise agreement, or alternatively may not be offered a renewal and must end their business.

Lack of independence to be completely innovative

A franchise business requires conformity to the policies and procedures established by the franchisors. Franchisees do not have the creative or innovative freedom to do whatever they please in the business, but must follow the system. Failure to follow
the system may result in the franchise being terminated, usually with little or no opportunity for a refund of the money invested in the business.

**Risk of franchisee business failure is not eliminated**

The risk of failure is part and parcel of any business venture, and in this regard franchising is no different. It is generally expected by franchisees that investing in a franchise will reduce their chances of business failure, but it can never completely eliminate the potential for failure. Franchisees should accept that there can be no guarantees of success in any business venture – franchised or otherwise – and should conduct extensive research in advance of the purchase decision to identify and reduce future risks.

**Franchises entering or developing new markets may be unknown among potential customers**

While a common benefit of franchising is the awareness of the franchisor’s brand and its products or services, when entering a new market such awareness may not exist and this benefit to the franchisee is substantially diluted. The franchisee’s own endeavours may be necessary to build the profile of the brand and demand for its products or services when pioneering a new market.

**Franchisees pay an additional levy for marketing in addition to franchise fees.**

In addition to any ongoing royalties (franchise fees) that a franchisee may be required to pay a franchisor, it is a common requirement to also pay a separate marketing fee or levy, which is pooled with contributions from other franchisees and used to fund marketing activities that promote the brand, and its products and services for the benefit of the group as a whole. This additional fee may not be adequately considered by the potential franchisee when undertaking their due diligence.

**Requirement for further marketing expenditure in local area**

Beyond the marketing levy described above, the franchisee may also be required spend a further proportion of their revenue on marketing in their own local area, and proof of this expenditure may be required by the franchisor.

**Risk of franchisor choosing unsuccessful marketing strategies or tactics**

Great emphasis is provided on the franchisor’s expertise in marketing and promoting the brand and its goods and services, but if the franchisor makes a poor choice in the strategy or tactical delivery of a marketing campaign, all of the franchisees in the network may be negatively affected.
Training may not meet expectations, or be primarily technical in nature

The expectations of franchisors and franchisees at the commencement of the franchise relationship may not match, particularly in relation to the core function of franchisee training. A franchisee may expect that the franchisor will train them in all facets of running the business, not just the technical operations, while a franchisor may only concentrate primarily on the technical operations and require the franchisee to build their own knowledge of other generic business skills. This mismatch of expectations can lead to early disappointment and frustration by the franchisee, who after training may require higher levels of field support than the franchisor expected or is able to provide.

Training for staff may not be available, or made available only at additional cost

Training for the franchisee’s staff may not be included in the initial price of the franchise, or may not be available at times, locations or costs acceptable to the franchisee.

The franchisor may have little or no site or territory selection criteria

Franchisees may expect that the franchisor will be expert at selecting appropriate sites or territories, but this may be a false assumption if the franchisor does not have a defined selection methodology, and may operate on little more than gut feel.

Support may not meet expectations

Likewise, the level of support that a franchisee may expect to receive after they have joined the franchise may not meet their expectations. The franchisor may not have the resources to provide the levels of support the franchise thought they were going to receive, or the support itself may not be as helpful as originally believed.

The requirement to pay franchise fees to the franchisor

Franchisees usually pay an upfront fee to join a system, as well as some kind of ongoing fee or royalty on a periodic basis. The royalty may eventually be perceived as a fee in payment of the support services provided by the franchisor, and may consequently seem to decline in value if the franchisee requires less support over time as they become more proficient in the operation of their business. The ongoing payment of fees to the franchisor, when the perceived value of the franchisor’s support has dropped, may cause future tension in the relationship.

Field visits may uncover non-compliance and result in a breach notice

The purpose of field visits is both to support the franchisee, and to check the franchisee’s compliance with the franchise system. A field visit may uncover non-compliance and result in a franchisee receiving a breach notice, which is a formal
written warning from the franchisor to fix a non-compliant part of the franchisee’s business or risk the franchise being terminated.

Risk that fellow franchisees damage the brand, and indirectly, your business

If the franchisor does not equally enforce compliance standards across the network, the actions of a non-compliant franchisee may damage the businesses of everyone else in the group.

Saturation in a mature market could result in encroachment by the franchisor or other franchisees

In a mature franchise system, franchisees may be placed so closely together that their businesses share customers and reduce the individual turnover of each business.

Franchisee may lack freedom of choice in suppliers

Unlike independent small businesses which can build their own supply networks, franchisees must usually deal with suppliers approved or endorsed by the franchisor, reducing the franchisee’s freedom of choice to deal with any other suppliers.

Franchisor may receive rebates on franchisee purchases from suppliers

The franchisor may also receive rebates from suppliers based on the volume of goods or services purchased by franchisees. In most cases, this may be a small acknowledgement to offset the cost of the resources required to negotiate and manage supply arrangements that benefit the network, but in some cases such rebates could mean the franchisee is paying more for their goods or services.

The franchisor may select the wrong people as franchisees

While franchising can make the transition into small business easier in a number of ways, a franchisor must be selective about the franchisees who are accepted to ensure the long-term integrity of the brand and compliance with the system. Franchisors who do not apply filters in the franchise selection process and take all comers risk allowing an unsuitable candidate into the system who may ultimately cause harm to their own business, the businesses of their fellow franchisees, or the brand and network as a whole.

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Please Note: This is not intended to be an exhaustive list of the advantages and disadvantages of franchising.

By undertaking this education program and conducting your own research, you may find others to add to this list.