Three Considerations When Franchising Your Business

By Eric Sigman on March 1, 2023

Franchising is a method of distributing products or services through the license of a brand and a system. It can be a lucrative growth strategy for a business (the franchisor) as it allows a business to grow its brand through providing the use of its intellectual property to others (the franchisee) in exchange for certain fees. The franchisor establishes a brand's trademark and system and the franchisee pays a royalty and other fees to the franchisor in exchange for the right to use its brand and system. Becoming a successful franchisor is not simple, however, and is filled with traps for the unwary.

There are three issues that any business considering franchising should analyze before embarking on the process:

1. Is the Business Model Replicable? Many businesses are extremely successful locally based mostly upon the goodwill of the business as it was developed by the founders. Factors such as the personality and skills of the founders, location, and clientele may not be easily replicated. Many businesses that grow to a few locations in a limited geographical area at some point consider franchising. The franchisor needs to be able to show that the business model can be replicated in different locations, with different owners, and with different market conditions. In order to be successful, Franchisors need to ensure that their business will consistently provide franchisees with the opportunity to share in the franchisor's success after they sign on and pay fees. Franchisors must have systems in place that can be easily replicated and implemented by individuals with backgrounds and skill sets different than the original business founder. Developing a strong system and a training program to teach franchisees that system can take a tremendous amount of time and resources.   However, selecting the right people to represent the brand's culture, values and goals is equally if not more important than the system itself.

2. Are the owners ready for Franchising? The transition to a franchisor can be a difficult undertaking for emerging franchisors. Typically, business owners have spent many years selling pizza or coffee or other goods and have an intimate understanding of how to operate their business. As stated above, one of the main challenges in franchising is being able to replicate that system in such a way to ensure consistency across the brand. As a result, when a business becomes a franchisor, the owners are no longer in the business of selling those goods or services – They are in the business of selling and managing franchises. Franchising carries with it a tremendous amount of legal, regulatory, financial, and other burdens. Most importantly, a franchisor is going to have to manage dozens if not hundreds of franchisees. Franchisees that are not following the

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system or are struggling will often cause a franchisor to incur significant administrative and legal costs. The management team must also be able to support and train a large number of franchisees in different geographic locations in order to have success. It's crucial to have a solid understanding of the financial implications of franchising and to create a realistic financial plan.

3. Does the business have the necessary legal foundation to franchise? Franchising is primarily about the brand. As a result, the cornerstone of a franchise system is one or more federally registered trademarks. Having a mark or marks is an integral legal aspect of a franchisor and should be registered at the outset of the process. In addition, in order to sell franchises, a franchisor must create a Franchise Disclosure Document or FDD under the Federal Trade Commission's Franchise Rule. This is a document containing 23 items including a franchise agreement and various disclosures about the business and the franchise system including a disclosure of fees and costs required of the franchisee, litigation history, audited financials, and other complex and detailed disclosures. In addition, the sales process is heavily regulated and carries with it a lot of risk if certain rules are not followed. Many states also have their own franchise and business opportunity laws and certain states require that franchisors register with a governmental agency in order to sell franchises in those states.

Franchising can be a great way to grow your business, but it is crucial to consider all the above factors before making the decision to franchise. Proper planning, attention to detail, and a commitment to providing high-quality training, support, and ongoing assistance are essential to the success of a franchise system.

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