FRANCHISING YOUR BUSINESS: PART 16

Looking ahead to the challenges of the second year

By **Nicola Broadhurst and Clive Sawyer**

In the latest article in her series for companies considering franchising their business, Nicola Broadhurst is joined by franchise consultant, Clive Sawyer to shed light on the issues that are likely to face the new franchisor in its second year.

With the launch of the franchise and its inevitable anxieties out of the way, this is the stage at which to tune the concept to equip it with the resources to sustain its long-term development.

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Companies in their first year in franchising naturally concentrate on making sure that their launch is successful and that their recruitment strategy is bringing in franchisees at an accelerating rate.

New franchisors face a steep learning curve and a heavy workload and it will be the exception if everything falls neatly into place and the business plan unfolds without hitches.

It is, therefore, hardly surprising to find that, although the franchisor will have launched its franchise with every intention of following the plan to the letter, development very often becomes reactive and piecemeal, rather than proactive and co-ordinated, and that sight of the longer-term strategy has been lost. What then is likely to be the scene at the start of the second year?

Having done all the hard work in recruiting their first franchisees and operating their network for a year, franchisors may be excused for thinking (at least to themselves) that it is time to draw breath and bask for a while in their achievement.

Most franchisors would probably admit that the task of franchising their business, recruiting their first franchisees, and supporting them through the first year was far harder and costlier than they had imagined. It is now important that they should build on their hard work and the lessons learned to ensure they have established a firm foundation on which they can develop their franchise further.

Having spent so much time developing a franchise business one would think that franchisors would be clear about their franchise strategy. They should not lose sight of the fact that franchising is only part of their overall business. They must constantly review franchising against their overall business strategy and not allow it to be the other way round with franchising dictating strategy.

Many would argue that by entering the franchise market, the franchisor has a moral and legal responsibility to its franchisees and, therefore, must ensure that the business is focused around them. Whilst we support the view that businesses should enter franchising with total commitment, the key fact cannot be ignored that the business must continually react to the ever-changing marketplace for both the benefit of its own profitability and that of its franchisees.

A business that stands still is no good for either party and a franchisor has a responsibility to its franchisees to constantly review its overall business strategy and its marketplace to ensure it has a coherent, robust strategy which not only meets the needs of the current market, but the those of its franchisees and customers.

Franchise agreement

It is best practice to ensure that the franchise agreement has kept pace with any changes in the business and that these are reflected in the agreement to ensure transparency.

The downside is that as a result of changes there will be franchisees who will be on slightly different terms, but on renewal most agreements require the franchisees to sign up to the then current agreement. This should ensure that eventually all franchisees are as far as possible operating on similar contractual terms as by this stage the business should be well established.

For existing franchisees, it is crucial that the agreement has sufficient flexibility to allow business developments to be incorporated into the existing franchise relationship and ensure compliance by franchisees. Often agreements contain clauses allowing franchisors to introduce improvements into the franchise system whether developed by the franchisor or the franchisee.

Some of the most valuable improvements have been generated by franchisees and it would be unwise to overlook the value of their involvement. Regular meetings between the franchisor and franchisee can help encourage discussions and become effective brain storming sessions. After the first year, when there hopefully will be a sufficient number of franchisees, the franchisor should look to promote regional or quarterly meetings.

It should not be overlooked that there are often cost implications to introducing improvements and franchisors need to consider carefully how these will be met. Often the agreement will not address this point and, therefore, by implication it is up to the franchisee to meet the costs of implementing changes if he is contractually obliged to comply with them.

This can occasionally produce dissension in the network and a franchisor would be well advised to discuss changes with franchisees well in advance, and highlight the obvious advantages to the network of implementing them in order to ensure the process is as smooth as possible.

Usually agreements contain a clause allowing the franchisor to amend the operations manual, and changes can be implemented simply by issuing a notice of an amendment to the manual. Care, however, needs to be taken over the way in which this discretion is used. It is clearly open to abuse and a franchisor should not use the opportunity to change the manual in such a way as to materially alter the rights which have been given to a franchisee under the agreement.

The ability to change the operations manual on an on-going basis is often a contentious issue for the prospective franchisee as he has little or no control over the way in which this is done and has to rely on the ethics and good nature of the franchisor.

Nicola Broadhurst

Learning from mistakes

Most franchisors, will admit they made mistakes in their first year and these can be extremely costly, particularly if they involve legal fees. The secret is to learn from them.

Franchisors are warned when embarking on their franchise recruitment to only sign-up franchisees with the right attributes, rather than compromising on quality simply because the candidate is waving a cheque.

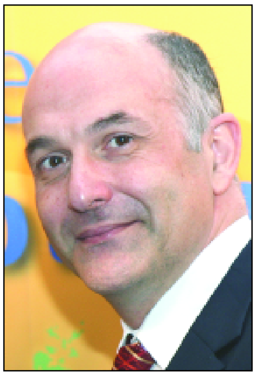
Despite being adamant at the outset that they will not compromise, most franchisors, not surprisingly do. When starting out, they face the dilemma of needing to get their franchise business started in order to begin recouping their financial outlay and achieve a number of franchisees to give prospective franchisees confidence in the business, whilst at the same time striving to recruit only the most suitable franchisees. Franchisors should accept this and, rather than be in denial, learn from the experience.

It is obviously important that franchisors should have a franchisee profile drawn up at the outset, but in the second year they should look at the profiles of their first franchisees and re-assess whether the original profile is still right. The franchisees that one thinks will be the best do not always turn out to be, and some of those that do not exactly fit the original profile turn out to be superstars.

Franchisors should fine tune their original franchisee profile in the light of their experience. If in the second year franchisors are tempted to recruit someone who does not fit the revised profile they should question their motives, and if it is purely down to adding another body to the network count they would be wise to resist the temptation.

Reviewing systems

Very few franchisors put in place a



Clive Sawyer

comprehensive franchisee support structure from day one. The support requirements for one or two franchisees are very different to those for even a network of only 10.

In an ideal world a franchisor would have a dedicated franchisee manager in place on day one and a complete belt-and-braces franchisee support system up and running. However, most fledgling franchisors cannot justify this financially.

It is the chicken and egg scenario. Does a franchisor invest vast amounts on having everything in place before the demand exists, or does it wait until there is a demand before putting in a full infrastructure? Common sense dictates that it is somewhere between the two.

There is a danger that if a franchisor invests heavily at the outset in a comprehensive infrastructure it will be reluctant to make changes as the franchise evolves. Equally, however, if a franchisor does not support its franchisees sufficiently from day one then there is a risk that the franchisees will not be as successful as expected. This obviously affects not just the franchisee's, but the franchisor's business as well as future franchise recruitment.

It is usually the case that a franchisor does a lot of personal handholding with its first few franchisees in the first year and it is this experience that prompts it to recruit a franchise manager, having realised how time consuming and demanding the work can be.

Challenges ahead

For most franchisors there are two key challenges in year two, recruiting more franchisees and ensuring that existing franchisees are as successful as possible.

At the franchise's start-up stage, the initial franchisees will not have had a pool of existing franchisees they could approach to verify whether the claims being made by the franchisor were true. There are no specific disclosure laws that require the franchisor to make available its trading figures and, therefore, the extent of the information obtained by a franchisee is usually down to the success of his own due diligence. However, when a franchise enters its second year there are likely to be a number of franchisees that prospective franchisees can approach.

The latter should not simply rely on one or two names which have been given by the franchisor, as these are likely to have been cherry picked. A full list should be requested from which the prospective franchisee can make a selection.

If these existing franchisees are disgruntled for whatever reason, such as lack of support or the initial financial projections being too ambitious, they will undoubtedly tell prospective franchisees. Too many negative views will ultimately curtail all future franchise recruitment.

It is, therefore, imperative that franchisors check that their franchisees are happy with the way their business is performing and the support they are given. Franchisors should not assume that as none of their franchisees have complained that they are happy.

Directly checking levels of satisfaction in the network and addressing issues that arise will lead to better performance and happier franchisees. This will assist the franchisor's future recruitment and improve its bottom line.

Again the regular meetings we mentioned earlier can assist in providing feedback and the franchisor may consider assisting franchisees to establish an association which can be consulted in a more formal and structured way. There does tend to be some resistance amongst franchisors to establishing such bodies as these are sometimes seen as hotbeds of discontent. However, if a franchisee is disgruntled he will find a way to air his grievances and it is better for the franchisor to be seen to be supporting its franchisees and seeking their views than to be suppressing them and in so doing create even more resentment.

Reinvesting

It is critical for any business to continually invest in its own development. This applies equally to franchise and non-franchised businesses. The investment can be in a number of areas, such as increased national advertising, product or service development, and increased support for the sales force.

Franchise agreements usually provide for national advertising contributions to be taken from franchisees (often between 2-3 per cent of gross revenue). This is paid into a central fund to finance national brand advertising.

In many cases the franchisor may be reluctant to impose this levy at the outset, where there are only one or two franchisees, but the agreement should clearly reserve the right to do so at a subsequent point in time, which is usually linked to the number of franchisees. This stage is likely to be reached in the second year and a prospective franchisee must be made aware of this at the outset.

The second year is also likely to be the stage at which the franchisor employs a full-time franchise manager if it has not already done so.

Occasionally franchisors at this early stage of their development are approached to expand internationally. It is our view that this is often too early. If the franchise support structure is not in place domestically it would be extremely risky to attempt international expansion as one or other is likely to be severely affected.

It is a wise franchisor who bides its time and ensures that all relevant support is in place before seeking new territories. Too often franchisors have been attracted by the lure of a master franchise fee far too early in their development.

Realism versus idealism

Many would argue that most of what we have proposed for the second year should have been put in place by the franchisor from the outset. This is very often simply not practical, both financially and operationally.

A good franchisor should ensure that its business is not put under an undue financial burden by slavishly following the textbook way of doing things, but instead ensure that it grows successfully and profitably by following sound business practice. Franchisors need to be realistic about what they can achieve.

Franchising done properly is a true partnership between franchisor and franchisee. The second year should be a time to cement this partnership with existing franchisees and build partnerships with new franchisees. The ideal franchisor marries franchising best practice with realism and practicality. FW