

ENTREPRENEURIAL MANAGEMENT – LECTURE 4

CHAPTER 4 – Franchise and Buyouts

LESSON 4

Franchise and Buyouts

Learning Objective 4.1 – Who Does the Research?

The franchise model has existed in many forms for a long period of time. According to some, the early Roman Catholic Church served as the blueprint for modern franchising, when the pope enabled parish priests to collect tithes and return a portion to the Vatican while keeping the remaining for parish maintenance. 1 Others date franchising back to the Middle Ages, when feudal lords granted some privileges to laymen in exchange for a fee and their compliance in carrying out specific community activities, such as ferry operation.

4-1a Franchising Terminology

If you are considering negotiating to purchase a franchise, you will need to understand the language that is used. Two United States government agencies, the Small Business Administration (www.sba.gov) and the Federal Trade Commission (www.ftc.gov), along with the International Franchise Association (www.franchise.org), are good sources of definitions of franchising terms.

If you're considering purchasing a franchise, you'll need to learn the lingo. The Small Business Administration (www.sba.gov), the Federal Trade Commission (www.ftc.gov), and the International Franchise Association (www.franchise.org) are all excellent resources for definitions of franchising words. According to the Small Business Administration, a franchise is a firm model in which a business owner licenses trademarks and procedures to an independent entrepreneur. A franchise is a legal and commercial arrangement between a franchisor (the owner of a trademark, service mark, trade name, or advertising symbol) and a franchisee (an individual or group wishing to use that identification in a business). A franchisee often sells items or services supplied by the franchisor or that fulfill the franchisor's quality criteria. The franchise agreement itself entitles the franchisee to conduct business under the franchisor's name and to gain trademark usage, support, and control.

4-1b The Impact of Franchising

The International Franchise Association (IFA) funds research into the economic impact of franchising in the United States. The IFA's objective is to safeguard, strengthen, and promote franchising. Since its inception in 1960, the IFA has grown to represent more than 70% of all registered franchisor firms in the United States, 10,000 franchisees, and providers of products, services, and help to franchise systems.

Learning Objective 4.2 – The Pros and Cons of Franchising

Purchasing a franchise may appeal to you for a multitude of reasons. The most significant advantage is the likelihood of success. Franchisors provide a tried-and-true business model. A credible franchisor has already experienced the ups and downs associated with beginning a business independently. One reason for franchises' low failure rate is how selective many franchisors are when awarding them; even financially qualified potential franchisees are occasionally refused. Franchising can also be used to diversify existing businesses. Successful small business owners may find themselves in mature industries with limited development opportunities. Their present company may give the resources necessary to acquire a franchise in a more lucrative field. As successful business owners, they may conclude that adopting a tried-and-true strategy will result in faster growth than beginning from scratch.

4-2b The Cons

The International Franchise Association's founders were upset by the dishonest and unethical behavior of some companies that were expanding through franchising and tarnishing the industry's reputation. Additionally, these businesses aimed to circumvent government oversight of franchising. Firms that join the IFA must adhere to a code of ethics based on the values of "trust, truth, and honesty." The code of conduct urges IFA members to demonstrate mutual respect and to communicate openly and frequently. Additionally, the IFA enforces compliance with applicable regulations and provides a dispute resolution service for franchisors and franchisees. However, some franchisors continue to participate in tactics that vex regulators, politicians, and the broader business community. These concerns, which include financial problems, franchisor competition, and management concerns, have prompted the Federal Trade Commission to impose restrictions and a few states to implement legislation.

Financial Issues

Major concerns have arisen regarding the true costs of becoming and remaining a franchisee. New franchisees of some franchise organizations have felt misled about their earnings opportunities

Franchisor Competition

On rare occasions, franchisors have competed directly against their franchisees. This can occur when the franchisor establishes a corporate-owned location near the franchisee's location or when the franchisor sells products by mail or the Internet. Encroachment is a variation on this complaint. When a franchisor sells another franchise site within the market area of an existing franchisee, this is referred to as encroaching on the franchisee's territory.

Management Issues

The franchisee's ability to run his or her own business is the subject of the final set of negative difficulties. You are not a fully independent business owner if you are a franchisee. You have a contract with the franchisor that specifies many requirements, including the products you carry, the services you provide, your hours of operation, and other aspects of how you conduct your business.

4-2c The Costs of Being a Franchisee

If you decide to become a franchisee, you will have to pay a fee. You're purchasing what should be a tried-and-true model, and the franchisor will charge you for the extras. Generally speaking, the more well-known and profitable franchises have higher expenditures. There are various components to franchise costs, all of which must be acknowledged and evaluated. The original franchise fee, investment fees, royalty payments, and advertising expenses are all included.

Learning Objective 4.3 – Evaluating Franchise Opportunities

4-3a Selecting a Franchise

The challenge of choosing an ideal franchise has been easier as franchising has grown in popularity over the years. Personal observation can pique curiosity, while exposure to an advertisement in a newspaper, magazine, or on the Internet can raise awareness.

4-3b Investigating the Potential Franchise

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The Franchisor As a Source of Information

Clearly, the franchisor under consideration is the key source of information. However, the information provided by a franchisor must be interpreted in the context of its intended use—promotion of the franchise. Reviewing franchisors' websites is one way to gather information about them. The majority of franchisor websites will be customer-facing, providing information about products, services, and retail locations. Additionally, the websites should provide information for prospective franchisees.

Existing and Previous Franchisees As Sources of Information

There is probably no more reliable source of franchise information than current and former franchisees. Occasionally, however, the distance between other franchisees' locations limits a visit to their site. In that situation, a phone call or e-mail to the owner may elicit their perspective.

4-3c Becoming a Franchisor

After a few years of self-employment, you may decide that you want to expand and that franchising is a viable alternative. It is not uncommon for successful business owners to be approached by others interested in becoming franchisees.

A Reproducible Model

Is your enterprise scalable? In other words, do you have a business model that another organization may adopt and successfully implement in another location? A franchisee acquires both an operating system and a product or service, as well as a brand name. Is your system effective, and can it be easily described to others?

Financial Considerations

How will you finance the company's expansion? Numerous entrepreneurs believe that franchising is an innovative method of financing their expanding businesses. They develop a concept, collect franchise fees, then reinvest the profits in expanding their business. However, franchising is not without expense to the franchisor. Legal documentation must be prepared, an operations manual must be written, staff must be hired, and several other duties must be accomplished.

Required Assistance

What professional support will you require in order to become a franchisor? Successful entrepreneurs quickly realize the importance of selecting the appropriate experts, individuals who are qualified to provide the necessary assistance.

Operations Manual

For the franchisor, this is a critical component of the value proposition offered to franchisees by the business model. What information will be included in your operations manual? Prior to writing the manual, many companies that have grown successfully through franchising brought in consultants who specialize in making the business operating model more efficient and reproducible.

Government Regulations

Are you willing to satisfy the government's disclosure requirements? The Federal Trade Commission issued an amended Franchise Rule in May 2008. This rule requires that the franchisor disclose certain information to prospective franchisees.

Long-Term Value

Can you consistently add value for your franchisees? There are numerous excellent and successful business models that may give you with the necessary measures to take in order to avoid common beginning errors. However, will your firm continue to provide value to prospective franchisees year after year?

4-3d Legal Issues in Franchising

Trust is critical for the success of a commercial collaboration. However, a contract is necessary to avoid or settle such conflicts.

The Franchise Contract

The franchise contract encapsulates the fundamental characteristics of the franchisor-franchisee relationship. Typically, this contract is a lengthy document with numerous pages.

Franchise Disclosure Requirements

State and federal laws regulate the offer and sale of franchises. The Franchise Rule establishes minimal disclosure standards at the federal level. The Federal Trade Commission's website (www.ftc.gov) includes a guide to the rule, as well as contact information for state offices that enforce franchise disclosure requirements.

Learning Objective 4.4 – Buying Existing Business

Another way to turn your ambition into a reality is to purchase an established firm. You may be just as entrepreneurial by purchasing an established business as you can by starting one from beginning. While examining potential businesses for acquisition, you may come upon an opportunity to turn around a struggling business. Or perhaps you possess the talents necessary to elevate an existing successful organization to new heights. A pre-existing business may be the ideal foundation for your dream.

4-4a Reasons for Buying an Existing Business

The following four broad categories summarize the motivations for purchasing an established business:

1. To alleviate some of the risks and unknowns inherent in beginning a firm from scratch.
2. To acquire an existing firm with ongoing operations and established customer and supplier relationships.
3. To acquire an established business at a fraction of the expense of starting a new firm or purchasing a franchise.
4. To enter business more swiftly than if one were to start from scratch Consider each of these reasons in greater detail.

Reduction of Uncertainties

A successful firm has already established its capacity to attract consumers, manage costs, and generate revenue. While future operations may change, the firm's track record demonstrates what it is capable of doing under genuine market conditions.

Acquisition of Ongoing Operations and Relationships

Typically, a buyer of an established business receives the business's people, inventories, physical buildings, established financial arrangements, and continuous contacts with trade suppliers and customers. Additionally, you are obtaining the past owner's goodwill.

A Bargain Price

If the seller is more eager to sell than the buyer is to buy, an established firm may appear to be available at a bargain price. However, whether it is a good buy must be decided by the prospective new owner. Numerous factors can conspire to turn a "bargain price" into anything but a bargain.

A Quick Start

The majority of entrepreneurs are ready to get started in their new business and may be unwilling to wait the months or even years required to build a business from scratch.

4-4b Finding a Business to Buy

Suppliers, distributors, trade associations, and even bankers are all potential sources of leads about firms for sale. Additionally, realtors—particularly those who specialize in the selling of business enterprises and commercial real estate—can supply leads.

4-4c Investigating and Evaluating Available Businesses

Regardless of the source of the lead, every business prospect requires thorough evaluation—what is occasionally referred to as due diligence. The buyer must first gather background information on the firm, which can be obtained through personal observation or dialogue with the seller.

Relying on Professionals

While many areas of due diligence require personal examination, a buyer may also consult with independent specialists. Accountants and lawyers are the two most useful outside resources.

Finding Out Why the Business is For Sale

The seller's true motivations for selling may or may not coincide with those mentioned. When a business is for sale, it is usually prudent to inquire about the owner's motivations for selling.

- Retirement
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- Illness
- Partnership or family disputes
- Unprofitability or failure of the business
- Burnout
- Lack of capital for growth potential

Examining the Financial Data

The first step in assessing a business's financial health is to examine its financial statements and tax returns for the preceding three to five years, or for as many years as available.

4-4d Quantitative Factors in Valuing the Business

After conducting the initial study and evaluation, the buyer must determine the firm's fair market worth. When appraising a business, the buyer will mainly rely on the financial data gathered during due diligence. It will include more than simply obtaining financial statements (income statements, balance sheets, and cash flow statements). The buyer will want to examine supporting papers that substantiate the financial statements' accuracy, including federal tax returns, state sales tax statements, supplier invoices, and customer receipts, as well as the company's bank records.

4-4e Nonquantitative Factors in Valuing a Business

You should also consider a number of nonquantitative factors in evaluating an existing business. In particular, is it likely that the firm you are considering buying might be subject to change regarding any of the following?

- Market.
 - Competition.
 - Future community development.
 - Legal commitments.
 - Union contracts.
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- Buildings.
- Product prices.

4-4f Negotiating and Closing the Deal

Negotiation between buyer and seller determines the buying price of a business. While the determined value may not be the final amount paid for the business, it provides an estimate for the buyer to consider while negotiating the price. Typically, the buyer attempts to purchase the firm for less than the entire assessed worth; naturally, the seller attempts to obtain a higher price.

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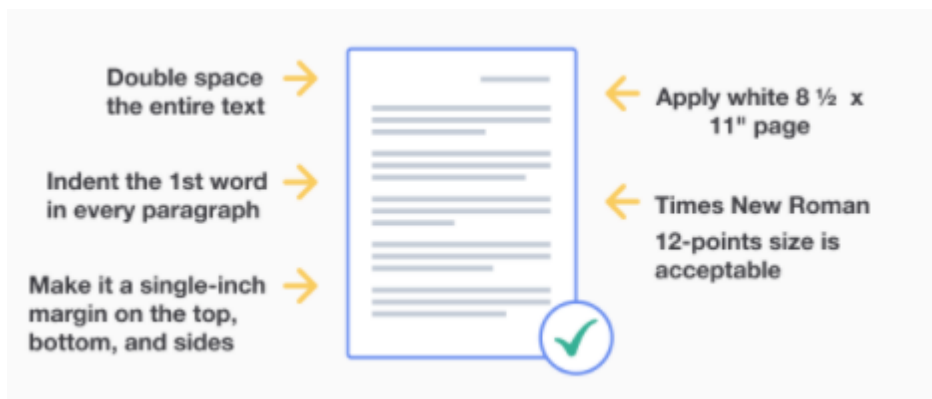
ONLINE SOURCES

- <https://dict.gov.ph/wp-content/uploads/2016/07/8.-SMEs-in-the-Philippines- Empowering-LGUs-through-ICT-Partnership-with-SUCs.pdf>
 - <http://web.b.ebscohost.com/ehost/detail/detail?vid=2&sid=a8555503-b5a2-4381-93ea-cecdca97caf2%40sessionmgr103&bdata=JnNpdGU9ZWwhvc3QtbGl2ZQ%3d%3d#AN=150269607&db=bsh>
 - <http://web.b.ebscohost.com/ehost/detail/detail?vid=5&sid=a8555503-b5a2-4381-93ea-cecdca97caf2%40sessionmgr103&bdata=JnNpdGU9ZWwhvc3QtbGl2ZQ%3d%3d#AN=126565663&db=bsh>
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Progress Check:

Requirements:

1. Due Date : _____
2. Essay format, minimum of 20 words and maximum of 100 words.
3. Format



4. Rubrics (40 points)

Criteria	Below Expectations	Proficient	Exemplary
Reasoning and Analysis	Weak reasons and/or irrelevant or confusing reasons given that don't support the answers; incomplete answers.	Reasons support answers with some / an important reason(s) overlooked; general examination and assessment.	Clear and accurate answers; insightful, specific.
Focus on Topic	Some of the documentation relates to the assigned topic; misuses or uses limited course vocabulary.	The answers are not as detailed and/or concise as needed; and/ or use limited course vocabulary.	Answers address the questions clearly and fully, showing higher level analysis and synthesis of concepts and uses course vocabulary.
Accuracy of Facts and Citations	No direct quotes or "work consulted" used or referred to in the paper. Incorrect facts and / or citations.	All facts are accurate and relate back to the answer, yet there was a disproportionate amount of opinion based statements then facts. Provided 2-5 citations throughout paper using the	All facts are accurate and relate back to the answer. Provided 2-5 citations throughout paper using the text, interview and or other related documentation.

		text, interview and or other related documentation.	
APA	No works cited.	Works cited is not formatted in the correct APA style.	Works cited is formatted in the correct APA style.
Mechanics/ Organization	Numerous errors, paper hard to read; questions are not stated before answers; format details are not adhered to.	Enough errors to distract the reader; organization problems; questions not stated before answers; and / or format difficult to navigate.	Use of correct grammar, spelling, and punctuation; well organized; one idea follows another in a logical sequence with clear transitions; questions stated before answers; format easy to navigate.
Timeliness	On time	late	No points

Questions

1. Define franchise, and have an understanding of franchise terminology.
2. Describe the process for evaluating a franchise opportunity
3. List four reasons for buying an existing business, and describe the process of evaluating an existing business.

Answer

1.
 - According to the U.S. Small Business Administration, a franchise is a business model involving a business owner (the franchisor) who licenses trademarks and methods to an independent entrepreneur (the franchisee). The franchise governs the method of conducting business between the two parties.
 - The franchisor also provides the business expertise (marketing plans, management guidance, financing assistance, site location, training, etc.) that otherwise would not be available to the franchisee.
 - A franchisee sells goods or services supplied by the franchisor or that meet the franchisor's quality standards.
 - In product and trade name franchising, the main benefit for the franchisee is the privilege of using a widely recognized product or trademark.
 - In business format franchising, entrepreneurs receive an entire marketing and management system.
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- The franchise contract is a legal agreement between a franchisor and franchisee.
 - A master licensee is an independent firm or individual acting as a middleman or sales agent with the responsibility of finding new franchisees within a specified territory.
 - Multiple-unit ownership, in which a single franchisee owns more than one unit of a franchised business, is becoming widely used.
 - Some single franchisees are area developers—individuals or firms that obtain the legal right to open several outlets in a given area.
 - Piggyback franchising is the operation of a retail franchise within the physical facilities of a host store.
 - Multibrand franchising involves operating several franchise organizations within a single corporate structure.
 - Co-branding brings two or more franchise brands together within a single enterprise
2. • Independent third parties such as state and federal government agencies, the International Franchise Association, and business publications can be valuable sources of franchise information.
- The primary source of information about a franchise is the franchisor.
 - Existing and previous franchisees are also good sources of information for evaluating a franchise.
 - Before becoming a franchisor, consider the efficiency of your business model, how you will finance growth, what expert assistance you will need, the content of your operations manual, government disclosure requirements, and your ability to add long-term value for franchisees.
 - A franchise contract is a complex document and should be evaluated by a franchise attorney, especially the provision relating to termination and transfer of the franchise.
 - The Franchise Disclosure Document (FDD) provides the accepted format for satisfying the franchise disclosure requirements of the FTC.
3. Buying an existing firm can reduce uncertainties.
- In acquiring an existing firm, the entrepreneur can take advantage of the firm's ongoing operations and established relationships with customers and suppliers.
 - An existing business may be available at a bargain price.
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- Another reason for buying an existing business is that an entrepreneur may be in a hurry to start an enterprise.
- Investigating a business requires due diligence.
- A buyer should seek the help of outside experts, the two most valuable sources of outside assistance being accountants and lawyers.
- The buyer needs to investigate why the seller is offering the business for sale.
- The company's financial statements and tax returns for the past three to five years should always be examined.
- Other quantitative factors in valuing a business include state sales tax statements, supplier invoices, customer receipts, and the company's bank statements.
- Nonquantitative factors in determining the value of a business for sale include the market, competition, future community development, legal commitments, union contracts, buildings, and product prices.
- The terms of purchase are an important part of the negotiation between buyer and seller.
- Documents completed during the closing include a bill of sale, tax and other government forms, and agreements regarding future payments and related guarantees to the seller.

Quiz

Identification

1. The owner of a trademark, service mark, trade name, or advertising symbol.
 2. _____ is based on mutual trust between the franchisor and franchisee.
 3. The _____ company is credited with being the first franchisor in the United States
 4. Franchisees are often required to contribute to _____ expenses beyond the royalties they pay on sales.
 5. Bringing two franchise brands together under one owner.
 6. Franchisors offer a business model with a proven _____
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7. It involves operating several franchise organizations within a single corporate structure
8. Costs associated with franchises include franchise fees, investment costs, royalty payments, and _____
9. It requires the franchisor to disclose certain information to prospective franchisees.
10. For a business alliance to be successful for both parties, _____ is important.

Answer

1. Franchisor
 2. Franchising
 3. Singer Sewing Machine
 4. Marketing
 5. Co-branding
 6. Track record
 7. Multi brand franchising
 8. Advertising cost
 9. Franchise rule
 10. Trust
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