Franchising basics

How franchising can expand your business

INTERVIEWED BY ROGER VOZAR

KACIE DAVIS
Associate
Kegler Brown Hill + Ritter

(614) 462-5402
kdavis@keglerbrown.com

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To a business owner looking for market penetration, establishing a franchise provides a number of benefits.

"We've taken clients operating from a few local locations to expanding into many states through franchising because they had aggressive expansion plans and were a great candidate to franchise," says Kacie Davis, an associate with Kegler, Brown, Hill + Ritter.

However, launching a franchise system isn't an easy get-rich-quick scheme.

"It's really a cost/benefit analysis for a business as to whether they're ready to expand and can support an on-going franchise system," says Davis.

Smart Business spoke with Davis about the process of franchising a business.

What is a franchise?

Essentially it's a business arrangement where one party grants rights to offer goods or services under its company or brand name. The seller provides significant control or assistance over the business, and the purchaser makes a minimum payment to enter into the arrangement.

What are the benefits of franchising?

Franchising allows you to build brand recognition and increase market share with a limited risk of financial exposure. Franchisors can shift the burden of operations and obtaining necessary capital to open new locations onto individual franchisees. Additionally, the franchise model provides new revenue streams to the franchisor by way of franchise fees and royalties. Franchisees also benefit because they start with a proven business model and leverage a successful brand name to tap into an immediate customer base.

How do you determine if a business is suitable for a franchise?

While it's somewhat intangible, there are certain hallmarks of successful franchises.

- The franchised business has one or more established and profitable locations.
- The business can be replicated into a turnkey operation.
- The concept is transferable to other markets or locations.
- The business has been lucrative and is attractive in terms of ROI.

Any type or size of business can be franchised, but a key component is its capability of supporting long-term franchisee relationships — a franchise system will only be successful if its franchisees are successful.

How is a franchise established?

In order to sell franchises, you must comply with Federal Trade Commission (FTC) regulations, which involves the preparation of a Franchise Disclosure Document (FDD). The FDD provides the franchisee with information on the business, the services the franchisor will provide and other information about the franchisor, including financial statements. Several states require registration of the FDD before franchises may be sold within that state. This means working with the state's attorney general or securities division.

In addition to the FDD, you'll need a franchise agreement and other contracts that detail the franchisee's compliance requirements, such as how they use your brand name and trademarks, and how you can enforce your rights.

In order to support your franchisees, you also need a very specific operations manual for the business and a training method to teach new franchisees how to operate the business and implement the operations manual. This will ensure uniformity and protect the franchised brand, ensuring consistency and increasing brand value.

What are some common problem areas?

One problem a business owner can run into when expanding is starting to sell a franchise without realizing it. People enter into licensing agreements thinking they are not selling franchises and can avoid FTC regulations and requirements. However, what can trip an owner up, and turn the license arrangement into a franchise arrangement, is providing the right to use your brand name in connection with providing assistance or control over that licensee's business operations.

Another risk is putting capital into franchising a business that wasn't market-tested. Without this, you don't know that anyone would buy into the concept and replicate the success you've had. ●