BUYING EXISTING FRANCHISE

Small and Medium Enterprises Development Authority

Ministry of Industries & Production

Government of Pakistan

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1. Introduction to SMEDA

The Small and Medium Enterprises Development Authority (SMEDA) was established in October 1998 with an objective to provide fresh impetus to the economy through development of Small and Medium Enterprises (SMEs).

With a mission "to assist in employment generation and value addition to the national income, through development of the SME sector, by helping increase the number, scale and competitiveness of SMEs", SMEDA has carried out ‘sectoral research’ to identify policy, access to finance, business development services, strategic initiatives and institutional collaboration and networking initiatives.

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3. What is a Franchise

A franchise is a type of license that grants a franchisee access to a franchisor's proprietary business knowledge, processes, and trademarks, thus allowing the franchisee to sell a product or service under the franchisor's business name. In exchange for acquiring a franchise, the franchisee usually pays the franchisor an initial start-up fee and annual licensing fees.

When a business wants to increase its market share or geographical reach at a low cost, it may franchise its product and brand name. A franchise is a joint venture between a franchisor and a franchisee. The franchisor is the original business. It sells the right to use its name and idea. The franchisee buys this right to sell the franchisor's goods or services under an existing business model and trademark.

Franchises are a popular way for entrepreneurs to start a business, especially when entering a highly competitive industry such as fast food. One big advantage to purchasing a franchise is you have access to an established company's brand name. You won't need to spend resources getting your name and product out to customers.

The franchise business model has a storied history in the United States. The concept dates to the mid-19th century, when two companies ‘’The McCormick Harvesting Machine Company’’ and the ‘’I.M. Singer Company’’ developed organizational, marketing, and distribution systems recognized as the forerunners to franchising. These novel business structures were developed in response to high-volume production and allowed McCormick and Singer to sell their reapers and sewing machines to an expanding domestic market. The earliest food and hospitality franchises were developed in the 1920s and 1930s. A&W Root Beer launched franchise operations in 1925. Howard Johnson Restaurants opened its first outlet in 1935, expanding rapidly and paving way for the restaurant chains and franchises that define the American fast-food industry until this day. There are more than 785,000 franchise establishments in the U.S., which contribute almost $500 billion to the economy. In the food sector, franchises included recognizable brands such as McDonald's, Taco Bell, Dairy Queen, Denny's, Jimmy John's Gourmet Sandwiches, and Dunkin' Donuts. Other popular franchises include Hampton by Hilton and Day's Inn, as well as 7-Eleven and Anytime Fitness.

4. Understanding the difference between franchising and buying and business

Before you decide if one of these options is right for you, make sure you know the basics of franchising and buying an existing business. The main difference between franchising and buying an existing business is the level of control you will have over your business.

Franchising gives you more guidance but less control.

A franchise is a business model where one business owner (the “franchisor”) sells the rights to their business logo, name, and model to an independent entrepreneur (the “franchisee”). Restaurants, hotels, and service-oriented businesses are commonly franchised.

Two common forms of franchising are

- **Product/trade name franchising**: The franchisor owns the right to the name or trademark of a business, and sells the right to use that name and trademark to a franchisee. This style of franchising normally focuses on supply chain management. Typically, products are manufactured or supplied by the franchisor and delivered to the franchisee to sell.
- **Business format franchising**: The franchisor and franchisee have an ongoing relationship. This style of franchising normally focuses on full-spectrum business

management. Typically, the franchisor offers services like site selection, training, product supply, marketing plans, and even help getting funding.

When you buy a franchise, you get the right to use the name, logo, and products of a larger brand. You'll also get to benefit from brand recognition, promotions, and marketing. But, it also means you have to follow rules from the larger brand about how you run your business.

Buying an existing business gives you more control but less guidance

Buying an existing business is exactly what it sounds like. The buyer typically takes over full ownership of the business. The largest advantage is having an existing blueprint that can include important factors like an established customer base, defined operating expenses, and fully trained employees. Regardless of business type, almost any kind of business could be bought or sold.
When you buy an existing business, you typically get complete control over its direction. However, with no set vision, infrastructure, or external guidance, your business could struggle as you figure out the best way to run things.

5. Franchise Basics and Regulations.

Franchise contracts are complex and vary for each franchisor. Typically, a franchise agreement includes three categories of payment to the franchisor. First, the franchisee must purchase the controlled rights, or trademark, from the franchisor in the form of an upfront fee. Second, the franchisor often receives payment for providing training, equipment, or business advisory services. Finally, the franchisor receives ongoing royalties or a percentage of the operation's sales. A franchise contract is temporary, akin to a lease or rental of a business. It does not signify business ownership by the franchisee. Depending on the contract, franchise agreements typically last between five and 30 years, with serious penalties if a franchisee violates or prematurely terminates the contract. In the U.S., franchises are regulated at the state level. However, the Federal Trade Commission (FTC) established one federal regulation in 1979. The Franchise Rule is a legal disclosure a franchisor must give to prospective buyers. The franchisor must fully disclose any risks, benefits, or limits to a franchise investment. This information covers fees and expenses, litigation history, approved business vendors or suppliers, estimated financial performance expectations, and other key details. This disclosure requirement was previously known as the Uniform Franchise Offering Circular before it was renamed the Franchise Disclosure Document in 2007.

6. Considering Factors before Buying Existing Franchise

Though the business models differ, there are three common steps to take that will help you determine whether you should franchise or buy a business.

- **Quantify your investment**: Review your financial landscape and decide how much you're willing to spend to purchase — and ultimately manage — the business. This will help you determine what type of businesses or brands are best for your budget.
- **Consider your talents and lifestyle**: Be honest about your skills and experience, as they can help you eliminate unrealistic business ventures. For example, if you prefer hands-on assistance, then franchising might be best for you. On the contrary, if you're an experienced business owner, you may want to consider buying an existing business.
- **Review the full landscape**: Look at the existing infrastructure and make sure you understand everything that comes along with the purchase. Don't be afraid to ask questions about contracts, leases, existing cash flow, and inventory. The more you know, the better equipped you'll be to make a sound decision.

7. Choosing the right franchise

Once you know whether you want to franchise or buy a business, you'll need to evaluate each specific opportunity. In short, it boils down to this, do your due diligence. Your research should help you understand the business from both a financial standpoint and in the overall landscape.

If you're interested in franchising, you should explore:

- **Any and all existing reports**: Now's the time to put your detective hat on. To start, get a Uniform Franchise Offering Circular (UFOC). This form contains vital details about the franchise's legal, financial, and personnel history.
- **Associated rules and regulations**: Every franchise is different. Confirm that you'll have the right to use the franchise name, trademark, and do business in an area protected from other franchisees. You can also find out if you'll get training and

management help from the franchisor, and be able to use the franchisor's expertise in marketing and advertising.

- **Contracts**: The contract between the two parties usually benefits the franchisor more than the franchisee. The franchisee generally needs to meet sales quotas and buy equipment, supplies, and inventory. Make sure you understand it all before signing.

8. Getting ready to buy the franchise

Once you've found a franchise or business to buy, it's important to conduct a thorough, objective investigation. At this stage, you'll probably want professional help. Consider hiring an attorney and an accountant. The tax rules surrounding franchises in particular are often complex. A specialist in franchise law can assist you with evaluating the franchise package and tax considerations. An accountant can help you determine the full costs of purchasing and operating the business, and even help estimate potential profit.

An attorney and an accountant together can help you create and evaluate important documents. Typically that includes the following:

- Letter of intent
- Confidentiality agreement
- Contracts and leases
- Financial statements
- Tax returns
- Sales agreement
- Purchase price adjustment

For further details resources from the Federal Trade Commission's Bureau of Consumer Protection may be visited to help you buy a franchise.