

# Franchising Basics for Business

## What is a franchise?

A franchise must include a **franchisor** and at least one **franchisee**.

The franchisor is the business or individual that sells the right to use its products or services to another business or individual. The franchisor:

- Allows the franchisee to use a name which is associated with the franchisor.
- Exercises continuing control over the franchisee.
- Provides assistance to the franchisee (for example, advice on finding and acquiring premises).

The franchisee is the business or individual that purchases the rights to use the franchisor's products or services. The franchisee will periodically have to make payments to the franchisor.

## What are the advantages of franchising for the franchisor?

- Franchising provides a business with the opportunity to secure distribution for products or services more quickly than if it had to train up its own employees and develop its own internal marketing, sales and distribution organisation.
- Using a franchisee's capital will enable a business to expand more quickly than if it had to find the funds itself.
- Many businesses involved in the supply of goods or services motivate their employees by linking their remuneration to sales. Franchising takes this one step further by linking the franchisee's financial well-being to the success of the franchisor's business.
- Franchising a business may provide the franchisor with increased purchasing power and possibly reduced overheads, therefore increasing its profitability.

## What are the disadvantages of franchising for the franchisor?

- Loss of control. While a franchise agreement will impose substantial restrictions on the franchisees, it is important to remember that they will be independent third parties who will be seeking to maximise their own profits, sometimes at the expense of the franchisor.
- Part of the franchisor's profits will be used to support the franchisee's business.
- By involving a third party, the franchisor will have to divulge substantial know-how and information concerning its business. Although a franchise agreement will contain restrictions on the franchisees' ability to make use of this information for their own purposes, these types of provisions are often difficult to monitor and enforce.
- The business skills required to control franchisees and provide back-up are different from those involved in operating a business with its own employees.
- A franchisor may owe a duty of care to its franchisees and prospective franchisees. The High Court has recently held that a franchisor must ensure that when they provide advice to a prospective franchisee, they must do so with due skill and care.

## **More information**

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