

# An Introduction to Franchising



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# An Introduction to

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# Franchising



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By Barbara Beshel

*The Money Institute*

[www.themoneyinstitute2000.com](http://www.themoneyinstitute2000.com)

## **FOREWORD & ACKNOWLEDGEMENTS**

*An Introduction to Franchising* is designed to introduce young people to the fascinating world of

# Chapter 1:

## An Introduction To Franchising

*What is a franchise? What are common franchise terms?*

*What are the alternatives to franchising?*

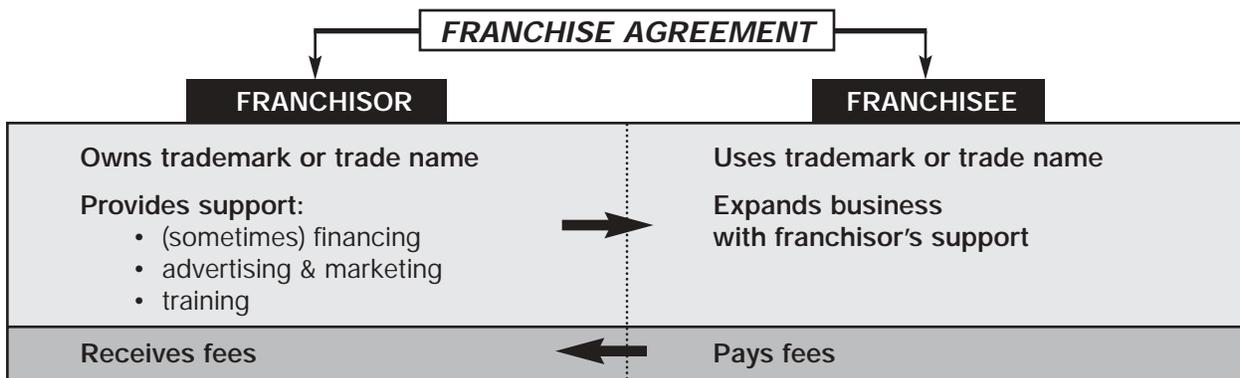
*What are the advantages and disadvantages of owning a franchise?*

*What are the legal issues in franchising?*

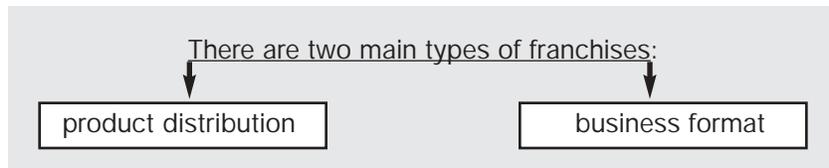
### WHAT IS A FRANCHISE?

A franchise is the agreement or license between two legally independent parties which gives:

- a person or group of people (franchisee) the right to market a product or service using the trademark or trade name of another business (franchisor)
- the franchisee the right to market a product or service using the operating methods of the franchisor
- the franchisee the obligation to pay the franchisor fees for these rights
- the franchisor the obligation to provide rights and support to franchisees



## Types of Franchises



**Product distribution franchises** simply sell the franchisor's products and are supplier-dealer relationships. In product distribution franchising, the franchisor licenses its trademark and logo to the franchisees but typically does not provide them with an entire system for running their business. The industries where you most often find this type of franchising are soft drink distributors, automobile dealers and gas stations.

Some familiar product distribution franchises include:

- ✓ Pepsi
- ✓ Exxon
- ✓ Ford Motor Company



Although product distribution franchising represents the largest percentage of total retail sales, most franchises available today are business format opportunities.

**Business format franchises**, on the other hand, not only use a franchisor's product, service and trademark, but also the complete method to conduct the business itself, such as the marketing plan and operations manuals. Business format franchises are the most common type of franchise.

*USA Today* reported that the 10 most popular franchising opportunities are in these industries:

- |                             |               |
|-----------------------------|---------------|
| ◆ fast food                 | ◆ retail      |
| ◆ service                   | ◆ automotive  |
| ◆ restaurants               | ◆ maintenance |
| ◆ building and construction | ◆ retail—food |
| ◆ business services         | ◆ lodging     |

## Some popular business format franchises include:

<p><b><u>Restaurants</u></b> KFC McDonald's Pizza Hut Taco Bell</p> <p><b><u>Retail</u></b> Blockbuster Video Radio Shack The Athlete's Foot GNC Franchising</p> <p><b><u>Lodging</u></b> Choice Hotels Bass Hotels/Holiday Inn Marriott Hotels</p>	<p><b><u>Health &amp; Beauty</u></b> Merle Norman Costmetic Studios Supercuts Jenny Craig International Cost Cutters Family Hair Care</p> <p><b><u>Business Services</u></b> Mail Boxes Etc. H &amp; R Block ACE America Cash Express Kwik Kopy</p>	<p><b><u>Maintenance/Cleaning</u></b> Jani-King International The ServiceMaster Company Merry Maids</p> <p><b><u>Automotive Service</u></b> Meineke Discount Mufflers AAMCO Transmissions Midas International Precision Auto Care</p> <p><b><u>Education/Training</u></b> Dale Carnegie Training Barbizon School of Modeling Berlitz International Sylvan Learning Systems</p>	<p><b><u>Real Estate</u></b> Century 21 RE/MAX International Coldwell Banker Residential Affiliates</p> <p><b><u>Convenience</u></b> 7-Eleven FamilyMart</p>
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### ***Types of Franchise Arrangements***

Because so many franchisors, industries and range of investments are possible, there are different types of franchise arrangements available to a business owner.

Two types of franchising arrangements:

- ✓ single-unit (direct-unit) franchise
- ✓ multi-unit franchise:
  - area development
  - master franchise (sub-franchising)

A **single-unit (direct-unit) franchise** is an agreement where the franchisor grants a franchisee the rights to open and operate ONE franchise unit. This is the simplest and most common type of franchise. It is possible, however, for a franchisee to purchase additional single-unit franchises once the original franchise unit begins to prosper. This is then considered a multiple, single-unit relationship.



A **multi-unit franchise** is an agreement where the franchisor grants a franchisee the rights to open and operate MORE THAN ONE unit.

There are two ways a multi-unit franchise can be achieved:

- ✓ an area development franchise or
- ✓ a master franchise.

Under an **area development franchise**, a franchisee has the right to open more than one unit during a specific time, within a specified area. For example, a franchisee may agree to open 5 units over a five year period in a specified territory.

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A **master franchise agreement** gives the franchisee more rights than an area development agreement. In addition to having the right and obligation to open and operate a certain number of units in a defined area, the master franchisee also has the right to sell franchises to other people within the territory, known as sub-franchises. Therefore, the master franchisee takes over many of the tasks, duties and benefits of the franchisor, such as providing support and training, as well as receiving fees and royalties.

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## WHAT ARE COMMON FRANCHISE TERMS?

**business format franchise** – this type of franchise includes not only a product, service and trademark, but also the complete method to conduct the business itself, such as the marketing plan and operations manuals

**disclosure statement** – also known as the UFOC, or Uniform Franchise Offering Circular, the disclosure document provides information about the franchisor and franchise system

**franchise** – a license that describes the relationship between the franchisor and franchisee including use of trademarks, fees, support and control

**franchise agreement** – the legal, written contract between the franchisor and franchisee which tells each party what each is supposed to do

**franchisee** – the person or company that gets the right from the franchisor to do business under the franchisor's trademark or trade name

**franchising** – a method of business expansion characterized by a trademark license, payment of fees, and significant assistance and/or control

**franchisor** – the person or company that grants the franchisee the right to do business under their trademark or trade name

**product distribution franchise** – a franchise where the franchisee simply sells the franchisor's products without using the franchisor's method of conducting business

**royalty** – the regular payment made by the franchisee to the franchisor, usually based on a percentage of the franchisee's gross sales

**trademark** – the franchisor's identifying marks, brand name and logo that are licensed to the franchisee

**UFOC** – the Uniform Franchise Offering Circular, UFOC, is one format for the disclosure document which provides information about the franchisor and franchise system to the prospective franchisee

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## WHAT ARE THE ALTERNATIVES TO FRANCHISING?

In addition to franchising, there are two other popular methods by which businesses expand their market and distribution channels:

- ✓ distributorships
- ✓ licensing



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## WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF OWNING A FRANCHISE?

The many advantages and disadvantages of owning a franchise should be carefully evaluated before deciding to purchase one.

### ***Advantages:***

- ✓ "Owning a franchise allows you to go into business for yourself, but not by yourself."
- ✓ A franchise provides franchisees with a certain level of independence where they can operate their business.
- ✓ A franchise provides an established product or service which already enjoys widespread brand-name recognition. This gives the franchisee the benefits of customer awareness which would ordinarily take years to establish.
- ✓ A franchise increases your chances of business success because you are associating with proven products and methods.
- ✓ Franchises may offer consumers the attraction of a certain level of quality and consistency because it is mandated by the franchise agreement.
- ✓ Franchises offer important pre-opening support:
  - site selection
  - design and construction
  - financing (in some cases)
  - training
  - grand-opening program
- ✓ Franchises offer ongoing support
  - training
  - national and regional advertising
  - operating procedures and operational assistance
  - ongoing supervision and management support
  - increased spending power and access to bulk purchasing (in some cases)

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### ***Disadvantages:***

- ✓ The franchisee is not completely independent. Franchisees are required to operate their businesses according to the procedures and restrictions set forth by the franchisor in the franchise agreement. These restrictions usually include the products or services which can be offered, pricing and geographic territory. For some people, this is the most serious disadvantage to becoming a franchisee.
- ✓ In addition to the initial franchise fee, franchisees must pay ongoing royalties and advertising fees.
- ✓ Franchisees must be careful to balance restrictions and support provided by the franchisor with their own ability to manage their business.
- ✓ A damaged, system-wide image can result if other franchisees are performing poorly or the franchisor runs into an unforeseen problem.
- ✓ The term (duration) of a franchise agreement is usually limited and the franchisee may have little or no say about the terms of a termination.

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## **WHAT ARE THE LEGAL ISSUES OF FRANCHISING?**

A good relationship between the franchisor and franchisee is critical for the success of both parties. Since franchising establishes a business relationship for years, the foundation must be carefully built by having a clear understanding of the franchise program. Unfortunately, understanding the legal language of franchising can be daunting. **The advice of an experienced franchise attorney should be sought to help a prospective franchisee understand the legal issues and to protect them from making costly mistakes.**

Franchising is governed by federal and state laws that require franchisors to provide prospective franchisees with information that describes the franchisor-franchisee relationship.

The two main franchising legal documents are the:

- ✓ the Disclosure Document, which may be in the format known as the UFOC.
- ✓ franchise agreement

### ***The UFOC***

The purpose of the UFOC is to provide prospective franchisees with information about the franchisor, the franchise system and the agreements they will need to sign so that they can make an informed decision.

In addition to the disclosure part of the document, the UFOC includes the actual franchise agreement as well as other agreements the franchisee will be required to sign, along with the franchisor's financial statements.

The UFOC is designed to give you some of the information you need in order to make an informed decision about investing in a particular franchise.

By law, a franchisor cannot offer a franchise until the franchisor has presented the prospective franchisee with a Disclosure Document. In fact, 14 states require franchisors to register their UFOCs with the state or to notify them that they will offer franchises before they begin to conduct any franchising activity in the state.

***The UFOC includes information about:***

- ✓ the franchisor
- ✓ the company's key staff
- ✓ management's experience in franchise management
- ✓ franchisor's bankruptcy and litigation history
- ✓ initial and ongoing fees involved in opening and running the franchise
- ✓ required investment and purchases
- ✓ territory rights
- ✓ responsibilities of the franchisor and franchisee
- ✓ other franchisees in the system with contact information

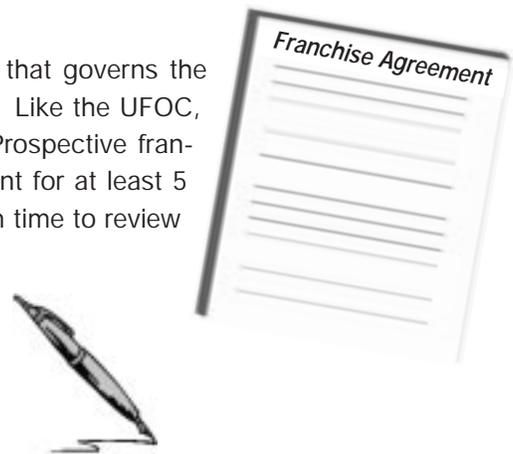
Receipt of the UFOC is governed by the "ten-day rule." This is a cooling-off period in which franchisors must give prospective franchisees 10 business days to think about their decision before they are allowed to sign the franchise agreement.

***The Franchise Agreement***

The franchise agreement is more specific than the UFOC about the terms of the relationship between the franchisor and franchisee. A typical franchise agreement may include specifics about:

- ✓ the franchise system, such as use of trademarks and products
- ✓ territory
- ✓ rights and obligations of the parties: standards, procedures, training, assistance, advertising, etc.
- ✓ term (duration) of the franchise
- ✓ payments made by the franchisee to the franchisor
- ✓ termination and/or the right to transfer the franchise

The franchise agreement is the legal, written document that governs the relationship and specifies the terms of the franchise purchase. Like the UFOC, the franchise agreement also enjoys a "cooling off" period. Prospective franchisees are legally entitled to have the final franchise agreement for at least 5 business days before they are allowed to sign. This gives them time to review and consider the terms of the agreement.



# Chapter 2:

## Beginning Your Search

*What are your options when you begin your business?*

*How do you investigate your options?*

*How do you investigate a franchise?*

*What are your criteria for selecting a franchise?*

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### WHAT ARE YOUR OPTIONS WHEN YOU BEGIN YOUR BUSINESS?

Once you make the decision to start your own business, you need to decide whether you want to be an independent business owner or a franchisee.

**Options for beginning a business:**

- ✓ start a new business
- ✓ buy a new franchise
- ✓ buy an existing franchise

#### *Starting A New Business*

##### Advantages

- + usually lower start-up cost
- + independence and creative freedom
- + freedom with location and procedures
- + no inherited problems from an existing business

##### Disadvantages

- requires more time and energy
- high risk of failure
- takes longer to become profitable
- financing may be more difficult to obtain



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## ***Buying A New Franchise***

### **Advantages**

- ◆ reduced risk of failure
- ◆ proven methods and products
- ◆ start-up assistance
- ◆ on-going training and support
- ◆ local, regional and national advertising
- ◆ collective purchasing power
- ◆ research and development
- ◆ association and synergy with other franchisees
- ◆ easier to obtain financing

### **Disadvantages**

- ◆ costs more (fees, royalties, supplies)
- ◆ smaller profit margins
- ◆ lack of independence and freedom
- ◆ difficult to achieve redress if franchisor fails to meet obligations
- ◆ a franchisor's problem may become your problem

## ***Buying An Existing Franchise***

### **Advantages**

- ◆ the business is already up and running
- ◆ risk and uncertainty may be reduced
- ◆ the basic infrastructure is in place:
  - ☞ established location
  - ☞ existing customers and reputation
  - ☞ employees
  - ☞ vendors
  - ☞ policies and procedures
  - ☞ cash flow
  - ☞ no start-up period—quicker profitability
  - ☞ easier to obtain financing

### **Disadvantages**

- ◆ tangible limitations:
  - ☞ design problems
  - ☞ location problems
  - ☞ merchandise problems
- ◆ intangible limitations:
  - ☞ customer or employee ill will
  - ☞ pricing problems
  - ☞ inadequate procedures
  - ☞ lease problems
- ◆ potentially higher costs to buy
- ◆ legal liability in inheriting lawsuits

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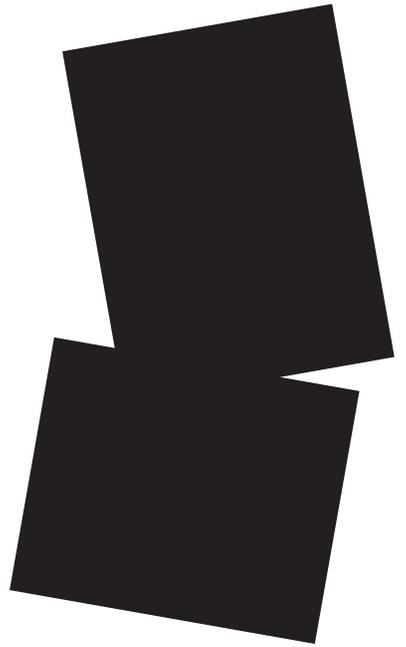
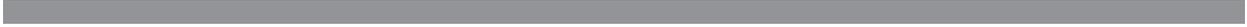
## **HOW DO YOU INVESTIGATE YOUR OPTIONS?**

Regardless of whether you choose to become an independent business owner or become a franchisee, research is the single most important activity in making your decision. Without adequate information, you may end up making the most costly decision of your life.

### **Steps for beginning a business:**

- ✓ What business?
- ✓ Is there a market?
- ✓ Can you afford it?
- ✓ Can you make enough money to make it worthwhile?





## Determine If You Can Afford To Start A Business

### MAKE PROFIT POTENTIAL YOUR MOST IMPORTANT CONSIDERATION!

In order to start a business, you have to have money!  
In order to stay in business, you have to make money!



The single most common reason new businesses fail is that they did not have enough money to begin with! Don't forget the old business adage: *"It takes twice as long and costs twice as much!"*

#### Costs to consider:

- ✓ Estimate your start-up costs:
  - location design and construction
  - professional fees
  - equipment and fixtures
  - furniture
  - opening inventory and supplies
  - insurance
  - Pre-opening labor
  - Opening advertising and promotion



- ✓ Estimate how much working capital you will need (the money you will need until the business becomes profitable—include your living expenses, if necessary)
  - salaries
  - insurance
  - utilities
  - advertising
  - rent
  - interest on a loan, if applicable



- ✓ Brainstorm where you might be able come up with money:
  - yourself
  - family
  - friends
  - savings and investments
  - a partner
  - selling personal assets
  - loans

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## ***Determine If You Can Make Enough Money To Make The Venture Worthwhile***

- ✓ Estimate the profit potential for the business:
  - income
  - expenses
  - profit (income – expenses)
  
- ✓ Think about the amount of time and energy it will take to make the business successful.
  
- ✓ Make a decision as to whether you think you can make enough money to make the entire venture worth your time and energy!

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## **HOW DO YOU INVESTIGATE A FRANCHISE?**

Like starting any business, buying a franchise involves a risk. Studies show that successful franchisees:

- ✓ conduct their own marketing research
- ✓ use their own financial and legal advisors
- ✓ develop thorough marketing and business plans
- ✓ have prior work experience

Prospective franchisees must devote a vast amount of time researching the franchises available and evaluating the strength of the franchisors.

### **Find out what franchises are available:**

- ✓ Read directories:
  - *The Franchise Opportunities Guide*
  - *The Executives' Guide to Franchise Opportunities*
  - *Bond's Franchise Guide*
  - *The Franchise Annual*
  - *Franchise Handbook*
  - *How Much Can I Make?*
  
- ✓ Read articles and ads in business publications:
  - *Inc.*: [www.inc.com](http://www.inc.com)
  - *Entrepreneur*: [www.entrepreneurmag.com](http://www.entrepreneurmag.com)
  - *Franchise Times*: [www.franchisetimes.com](http://www.franchisetimes.com)
  - *Franchising World*: [www.franchise.org](http://www.franchise.org)
  - *Franchise Update*: [www.franchise-update.com](http://www.franchise-update.com)
  - *The Wall Street Journal*: [www.wsj.com](http://www.wsj.com)

✓ Attend trade shows and expositions:

- IFE (International Franchise Expo) is sponsored by the International Franchise Association (IFA: 202-628-8000 or [www.franchise.org](http://www.franchise.org)) and is the world's largest gathering of franchise companies.
- The U.S. Small Business Administration and Small Business Development Centers (SBA: [www.sbaonline.sba.gov/sbdc/](http://www.sbaonline.sba.gov/sbdc/))

✓ Conduct research on the internet:

- Federal Trade Commission — [www.ftc.gov/bcp/menu-fran.htm](http://www.ftc.gov/bcp/menu-fran.htm)
- Small Business Administration — [www.sba.gov](http://www.sba.gov)
- International Franchise Association — [www.franchise.org](http://www.franchise.org)
- *Entrepreneur Magazine* — [www.entrepreneurmag.com](http://www.entrepreneurmag.com)
- *Franchise Update Magazine* — [www.franchise-update.com](http://www.franchise-update.com)
- *IFA Franchise Opportunities Guide* — [www.franchise.org](http://www.franchise.org)
- *Franchise Handbook* — [www.franchise1.com](http://www.franchise1.com)
- Source Book Publications — [www.worldfranchising.com](http://www.worldfranchising.com)



**Evaluate the strength of the franchisor:**

✓ Investigate the franchisor's history:

- How long has the franchisor been in business?
- How many current franchisees are there?
- What is the failure rate of the franchisees?
- Are there any pending or past lawsuits and what have they been for?
- Does the franchisor have a reputation for quality products or services?
- What is the franchisor's financial health (get its Dun & Bradstreet rating)
  - credit rating
  - profitability
  - reputation
- What are the earnings claims and profit projections?
  - On what are they based?
  - Are the projections based on franchisor or franchisee-run units?
  - How long have the units used for projections been in business?
- What is the background of the principals/management?
  - What is their business experience?
  - Have they personally had any bankruptcies?
  - Have they personally had any recent litigation?









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- ✓ **Obligations and duties of the franchisor.** This section describes, in detail, all the services which the franchisor will provide:
    - training
    - operations support
    - advertising
  
  - ✓ **Obligations and duties of the franchisee.** This section describes the franchisee's responsibilities:
    - requirements for training
    - requirements for participation in the business
    - requirements for keeping and submitting adequate records
  
  - ✓ **Restriction on goods and services offered.** This section describes any restrictions placed on the goods or services offered, including:
    - required quality standards
    - approved suppliers
    - approved advertising
    - hours of operation
    - pricing
  
  - ✓ **Renewal, termination and transfer of franchise agreement.** This section includes:
    - the rights and obligations of a franchisee upon termination
    - descriptions about the transfer of the franchise agreement
    - descriptions about the renewal of the franchise agreement

**Make sure you hire an experienced  
franchise attorney to review the agreement!**



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## WHAT INFORMATION IS FOUND IN THE DISCLOSURE DOCUMENT (UFOC)?

The purpose of the UFOC is to provide prospective franchisees with information about the franchisor, the franchise system and the agreements they will need to sign so that they can make an informed decision.

### *The Disclosure Document (UFOC)*

- ✓ **Item 1: The franchisor, its predecessor and affiliate.** This section provides a description of the company.

- ✓ **Item 2: Business experience.** This section provides biographical and professional information about the franchisors and its officers, directors and executives.
- ✓ **Item 3: Litigation.** This section provides relevant current and past criminal and civil litigation for the franchisor and its management.
- ✓ **Item 4: Bankruptcy.** This section provides information about the franchisor and any management who have gone through a bankruptcy.
- ✓ **Item 5: Initial franchise fee.** This section provides information about the initial fees and the range and factors that determine the amount of the fees.
- ✓ **Item 6: Other fees.** This item provides a description of all other recurring fees or payments that must be made.
- ✓ **Item 7: Initial investment.** This item is presented in table format and includes all the expenditures required by the franchisee to make to establish the franchise.
- ✓ **Item 8: Restriction on sources of products and services.** This section includes the restrictions that franchisor has established regarding the source of products or services.
- ✓ **Item 9: Franchisee's obligations.** This item provides a reference table that indicates where in the franchise agreement franchisees can find the obligations they have agreed to.
- ✓ **Item 10: Financing Available.** This item describes the terms and conditions of any financing arrangements offered by the franchisor.
- ✓ **Item 11: Franchisor's Obligations.** This section describes the services that the franchisor will provide to the franchisee.
- ✓ **Item 12: Territory.** This section provides the description of any exclusive territory and whether territories will be modified.
- ✓ **Item 13: Trademarks.** This section provides information about the franchisor's trademarks, service marks and trade names.
- ✓ **Item 14: Patents, copyrights and proprietary information.** This section gives information about how the patents and copyrights can be used by the franchisee.
- ✓ **Item 15: Obligations to participate in the actual operation of the franchise business.** This section describes the obligation of the franchisee to participate in the actual operation of the business.

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- ✓ **Item 16: Restrictions on what the franchisee may sell.** This section deals with any restrictions on the goods and services that the franchisee may offer its customers.
  - ✓ **Item 17: Renewal, termination, transfers and dispute resolution.** This section tells you when and whether your franchise can be renewed or terminated and what your rights and restrictions are when you have disagreements with your franchisor.
  - ✓ **Item 18: Public Figures.** If the franchisor uses public figures (celebrities or public persons), the amount the person is paid is revealed in this section.
  - ✓ **Item 19: Earnings claims.** Here the franchisor provides information that a franchisee can use to estimate what can be earned from the business.
  - ✓ **Item 20: List of franchise outlets.** This section provides locations and contact information of existing franchises.
  - ✓ **Item 21: Financial statements.** Audited financial statements for the past three years are included in this section.
  - ✓ **Item 22: Contracts.** This item provides of all the agreements that the franchisee will be required to sign.
  - ✓ **Item 23: Receipt.** Prospective franchisees are required to sign a receipt that they received the UFOC.

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## WHAT ARE THE KEY ITEMS IN THE DISCLOSURE DOCUMENT?

### *Item 7: Initial investment.*

- ✓ Some of these costs are averages or estimates and may vary in your area.
- ✓ Talk to other franchisees who have been in the system for a year or more to see:
  - how much money they needed in the beginning until they became profitable
  - how much they were able to draw from the business to support themselves

### *Item 11: Franchisor's obligations.*

- ✓ Be sure you understand the services you will get before you open:
  - site selection
  - training
  - development assistance



- 
- ✓ Be sure you know what services you will receive for your grand opening:
    - marketing
    - advertising
    - field support
  
  - ✓ Be sure you know what services you will receive after you begin operating your business:
    - training
    - advertising
    - operations
  
  - ✓ Pay particular attention to those services the franchisor is **obligated to provide** and the services they **may provide**.

***Item 17: Renewal, termination, transfers and dispute resolution.***

- ✓ Take your time to understand what rights you will have and what rights you are giving up.
  
- ✓ Pay particular attention to any non-compete provisions and your obligations when the franchise relationship ends.

***Item 19: Earnings Claims.***

- ✓ Only 20 to 25 percent of all franchisors provide prospective franchisees with information about earnings claims. The next best thing to do is to talk to existing franchisees about earnings potential.
  
- ✓ Another good source of information is *How Much Can I Make?* by Robert Bond. (800-841-0873 or [www.worldfranchising.com](http://www.worldfranchising.com)).

***Item 20: List of franchise outlets.***

- ✓ Examine how many units the franchisor has taken back and resold. If this number is high, this could indicate churning (when the franchisor takes back failed locations and remarkets them over and over.)
  
- ✓ Pay attention to the contact information of the franchisees who have left the system. These are people you definitely want to talk to.

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### ***Item 21: Financial statements.***

- ✓ Financial statements are the track record of the franchisor. You should be given copies of the franchisor's last two or three years financial statements. Take them to an accountant who specializes in franchising to evaluate.
- ✓ Remember that the financial condition of the franchisor not only affects its ability to run a financially successful operation in the future, but it also determines whether it may go under and you will be left "holding the bag."
- ✓ The two key financial statements to focus on are the balance sheet and the income statement. Make sure they are audited.

### ***Item 22: Contracts.***

- ✓ Make sure that all the agreements listed are attached to the UFOC—and read every one of them.

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## **WHAT DO YOU HAVE TO KNOW ABOUT FINANCIAL STATEMENTS?**

Financial statements are the track record of the franchise. They are provided for you in the UFOC and

## SAMPLE BALANCE SHEET

ABC SLEEPWEAR  
Balance Sheet  
January, 2000

### ASSETS

Current Assets	\$ 6,000
Cash	4,900
Accts. Receivable	8,000
Inventory	200
Prepaid Expenses	
Total Current Assets	\$19,100
Fixed Assets	8,500
Machinery	1,000
Computer/Printer	4,500
Furniture	
Total Fixed Assets	\$14,000
Total Assets	\$33,100

### LIABILITIES AND EQUITY

Current Liabilities	\$6,500
Accounts Payable	1,200
Current Long-term Due	1,800
Accrued Expenses	
Total Current Liabilities	\$9,500
Long-Term Liabilities – Note	\$12,500
Stockholders' Equity	\$20,600
TOTAL LIABILITIES AND EQUITY	\$33,100



**Things you want to see on a franchisor's balance sheet:**

- ◆ increasing assets
- ◆ increasing stockholders' equity
- ◆ more cash than debt
- ◆ amount of current debt < (less than) 1/2 of the total assets
- ◆ amount of current debt < 1/3 of the stockholders' equity

***The Income Statement***

An income statement reports a company's profit or loss. It shows a company's income, expense and net income—also known as the “bottom line” or earnings.

**Other names for an income statement include:**

- ◆ Profit and Loss Statement
- ◆ Statement of Income
- ◆ Statement of Operation
- ◆ Statement of Earnings
- ◆ Results of Operations
- ◆ Statement of Consolidated Income

**Income statement categories include:**

- ◆ revenues
- ◆ costs and expenses: cost of sales, selling, general administrative, interest expenses
- ◆ income before taxes
- ◆ provision for income taxes
- ◆ net income (earnings)
- ◆ net income (earnings) per share

## SAMPLE INCOME STATEMENT

ABC SLEEPWEAR  
Income Statement  
January, 2000

SALES/REVENUES		\$2,670
		1,776
COST OF GOODS		
Merchandise	1,155	
Purchases	610	
Freight	11	
		894
GROSS PROFIT		544
OPERATING COSTS & EXPENSES		
Fixed		
Insurance	26	
Rent	100	
Salaries	310	
Utilities	42	
Variable		
Advertising	24	
Dues	4	
Telephone	24	
Office Supplies	14	
		350
PROFIT (INCOME) Before Taxes		105
TAXES (30%)		\$245
<b>NET PROFIT (NET INCOME)</b> ("The Bottom Line")		

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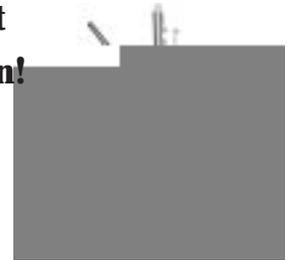
**Things you want to see on a franchisor's income statement:**

- ◆ increasing profit
- ◆ more revenue derived from royalties and system income than from selling franchises
- ◆ increasing revenue trends, usually > 15%
- ◆ increasing net income trends, usually > 15%
- ◆ increasing net income per share trend, usually > 15%
- ◆ a profitable franchisor!

**What you should know about these financial statements:**

- ◆ The financial statements should be audited financial statements.
- ◆ The statements should contain two to three years of financial data.

**You should take these to an accountant  
experienced in franchising for evaluation!**



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**WHERE CAN I GET HELP?**

- ✓ International Franchise Association (IFA), 202-628-8000, [www.franchise.org](http://www.franchise.org)
- ✓ American Bar Association's Forum on Franchising, [www.abanet.org](http://www.abanet.org)  forums  franchising
- ✓ IFA's Supplier Forum publishes a list of firms that specialize in franchising law

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# Chapter 4:

## Evaluating a Franchise-- Interviewing Both Sides

*What should I ask the franchisor?*

*What should I ask the franchisees?*

*What questions should I ask myself before buying a franchise?*

*What are the keys to franchise success?*

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### WHAT SHOULD I ASK THE FRANCHISOR?

#### **About the franchisor:**

- ✓ Who owns the trademarks, service marks, etc., and are they federally registered?
- ✓ Are there any disputes pending or threatened against the trademarks?
- ✓ Has the franchisor complied with the FTC and state disclosure laws?
- ✓ Are any senior management or key personnel leaving the system?
- ✓ Does this company compete with the franchisees in the marketplace?
- ✓ Will the franchisor finance any of the costs?
- ✓ Is the franchisor willing to negotiate the terms of the franchise?
- ✓ Does the franchisor staff attend seminars on franchising and management?
- ✓ Do field consultants offer help and guidance or merely act in a regulatory role?
- ✓ How many franchises are expected to be added each year?
- ✓ Where will they be located?
- ✓ What is the success rate of existing franchises?
- ✓ What method is used to protect franchisees from poorly performing franchises?
- ✓ Is there a franchise owners association?
- ✓ Is there a franchise advisory council?

### **About costs:**

✓ What is the total investment required to own a franchise?

- franchise fee
- furniture, fixtures and equipment
- leasehold improvements
- lease deposits
- other deposits
- franchise training
- travel expense
- supplies
- advertising and brochures
- grand-opening advertising
- inventory
- pre-opening staff costs
- working capital until breakeven
- working capital – living expenses
- other

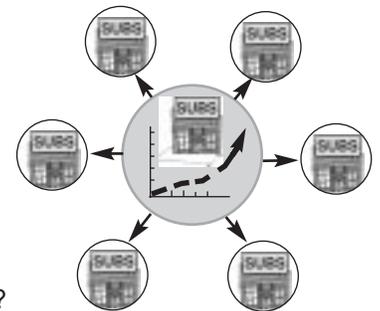


✓ What are the continued financial costs, the basis used for calculation, method of payment and frequency of payment:

- royalties
- advertising

✓ Must the franchisee purchase products or services from the franchisor:

- Does the franchisor earn income on purchases?
- How much does the franchisor earn?
- How are the products distributed?
- How long does it take for the orders to be filled?
- What other initial or continuing services does the franchisor provide?  
What do these cost?



### **About consumer research and marketing:**

✓ What type of consumer research has the company conducted?

✓ What were the results?

✓ Has the franchisor conducted any market studies on the territory to ensure that it can support a franchise?

- What are the demographics required to support a franchise?
- What are the traffic counts required to support a franchise?



### **About training:**

- ✓ What are the location, duration and additional costs of initial training?
- ✓ Who must attend the training?
- ✓ What is the cost of additional staff attending training?
- ✓ What is the training curriculum?
- ✓ Who conducts the training and what are their backgrounds?
- ✓ Who pays for transportation, room and living expenses?
- ✓ Does the franchisor provide training materials for training new staff in addition to the operations manuals?
- ✓ Does the franchisor provide hands-on assistance during the pre-opening, grand opening and initial period? Of what type, duration and cost?



### **About products and services:**

- ✓ Are there any new products or services under consideration for addition to the franchise?
- ✓ When are they going to be introduced?
- ✓ What is the estimated additional cost for adding the new products or services?
- ✓ Are there any restrictions on the distribution or sale of the product?
- ✓ Is there a guarantee or warranty program? How is it administered and what is the cost?
- ✓ Is there a minimum that must be purchased?

### **About advertising and marketing:**

- ✓ What type of consumer advertising does the company recommend?
- ✓ What types of cooperative advertising programs are being used?
- ✓ What percentage of sales is recommended or required for advertising or marketing?
- ✓ How do the franchisees obtain their sales leads or customers?
- ✓ What is the franchisor's national/regional advertising program and budget?
- ✓ What portion of the national/regional advertising contribution is used for administrative/corporate/agency expenses and fees?
- ✓ What are the primary advertising/marketing vehicles?
- ✓ What is the grand opening advertising program and cost?



### **About operations:**

- ✓ What are the roles and responsibilities of the field staff?
- ✓ How many locations does each franchise consultant work?
- ✓ What is the background of the franchise consultant I will be working with?  
Can I meet that person before purchasing the franchise?
- ✓ How often does the field staff visit a franchisee's location?
- ✓ What is the additional cost of field services if the franchisee requires it?
- ✓ Exactly what kind of assistance is given?
- ✓ What kind of supervision or quality control is there?
- ✓ What, if any, is the charge for assistance?
- ✓ What kind of business management systems are provided to boost sales and profits?



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## WHAT SHOULD I ASK THE FRANCHISEES?

### **About the franchisor:**

- ✓ How much support do you get?
- ✓ Are you satisfied with the franchisor?
- ✓ Is the franchisor fair and easy to work with?
- ✓ Does the franchisor listen to your concerns and accept input from the franchisees?
- ✓ Have you had any disputes and, if so, were you able to settle them?
- ✓ Do you know of any trouble the franchisor has had with other franchises, competitors or the government?
- ✓ Has the franchisor kept its promises?

### **About costs:**

- ✓ Is your franchise profitable?
- ✓ What are your gross revenues?
- ✓ What have your pre-tax profits been for the past three years?
- ✓ What is your salary?
- ✓ How is your cash flow?
- ✓ Were the franchisor's start-up costs and working capital requirements accurate?
- ✓ Were the franchisor's profit projections and earnings claims accurate?
- ✓ How long did it take you to break-even?
- ✓ Have you made the profit you expected to make?

### **About training:**

- ✓ Was the training by the franchisor adequate?
- ✓ Was the training by the franchisor effective?

### **About products and services:**

- ✓ Is the product or service you sell of good quality?
- ✓ Is delivery of goods from the franchisor adequate?
- ✓ Are you getting supplies more cheaply from the franchisor than you could on your own?
- ✓ What does the franchisor supply?

### **About advertising and marketing:**

- ✓ How much do you spend on advertising a month?
- ✓ How effective is the reg 2 ng

- ✓ Are the manuals updated on a regular basis?
- ✓ What did you do before you bought the franchise?
- ✓ Describe your day.
- ✓ How many hours a day do you work?
- ✓ How many hours a week do you work?
- ✓ How much freedom do you have to make decisions?
- ✓ Are you happy with your investment?
- ✓ Are you disappointed in any aspect of the business?
- ✓ Is there anything about the business you do not like?
- ✓ What do you like most about the business?
- ✓ What kind of problems do you encounter?
- ✓ What do you like least about the business?
- ✓ Would you do it again?
- ✓ Would you recommend I buy a franchise?




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## WHAT QUESTIONS SHOULD I ASK MYSELF BEFORE BUYING A FRANCHISE?

**There are three main sets of questions you should ask yourself:**

- ✓ Do I have what it takes to start my own business/be an entrepreneur?
- ✓ Do I have what it takes to be a franchisee?
- ✓ Do I have all the answers I need about the franchise I am considering buying?

### ***Do I Have What It Takes To Start My Own Business/Be An Entrepreneur?***

So you want to be an entrepreneur? You're not alone! Consider these statistics:

- ☞ 55% of all Americans want to be their own boss.
- ☞ 37% of all households are involved in small business.
- ☞ 70% of all high schools students want to start a business.
- ☞ 1 out of every 25 adults is currently starting a business.
- ☞ 5 million people started a business in 1995.



An entrepreneur is defined as:

- ◆ “One who pursues opportunity beyond the resources currently controlled.”
- ◆ “A person who sees an opportunity and creates an organization to pursue it.”
- ◆ “A dreamer who attempts to turn an idea into a profitable reality.”
- ◆ “Anyone who assumes the risk and responsibility for starting and managing a business.”
- ◆ “Anyone who takes the risk of starting a business for the purpose of making a profit.”

**Entrepreneurs have a different way of looking at life:**

**Opportunity** .....*INSTEAD OF*.....Security  
**Results** .....*INSTEAD OF*.....Routine  
**Profit** .....*INSTEAD OF* .....A Paycheck  
**Trying New Ideas** .....*INSTEAD OF* .....Avoiding Mistakes  
**Vision**.....*INSTEAD OF* .....Short-Term Gain

**The advantages of being an entrepreneur:**

- + freedom and independence
- + control over a major aspect of your life
- + an outlet for creativity
- + excitement
- + satisfaction and sense of achievement
- + self-esteem
- + status and recognition
- + flexibility
- + job security—you cannot be fired or laid off
- + unlimited income potential
- + growth of initial monetary investment



**The disadvantages of being an entrepreneur:**

- risk
- responsibility and pressure
- fear of failure
- obstacles and frustration
- loneliness
- more work
- longer hours
- less time or energy to spend with friends and family
- less financial security
- fewer job benefits
- risk of losing investment
- income fluctuation
- you are responsible for your own portion of taxes and FICA



Entrepreneurial self-assessment:

Starting a successful business takes a tremendous amount of energy and certain personal characteristics. Read each of the characteristics below and circle the number that most accurately describes your entrepreneurial potential on a scale of one to ten. (1 is low, 10 is high)

<b>Characteristic</b>	<b>Description</b>	<b>Your Tendency (low to high)</b>
Motivation	drive, energy to succeed	1 2 3 4 5 6 7 8 9 10
Enthusiasm	excited involvement	1 2 3 4 5 6 7 8 9 10
Risk-taker	willing to take chances	1 2 3 4 5 6 7 8 9 10
Confidence	sure of your own abilities	1 2 3 4 5 6 7 8 9 10
Competitiveness	wanting to win	1 2 3 4 5 6 7 8 9 10
Perseverance	refusal to quit a task	1 2 3 4 5 6 7 8 9 10
Creativity	imaginative thinking	1 2 3 4 5 6 7 8 9 10
Organization	keeping things in order	1 2 3 4 5 6 7 8 9 10
Vision/leadership	knowing where you want to be	1 2 3 4 5 6 7 8 9 10
Persuasiveness	ability to convince others	1 2 3 4 5 6 7 8 9 10
Honesty	truthfulness	1 2 3 4 5 6 7 8 9 10
Adaptability	can handle new situations	1 2 3 4 5 6 7 8 9 10
Understanding	can sense peoples' feelings	1 2 3 4 5 6 7 8 9 10
Self-discipline	sticking to a plan or schedule	1 2 3 4 5 6 7 8 9 10
Independence	belief in oneself	1 2 3 4 5 6 7 8 9 10
Purposefulness	doing things for a reason	1 2 3 4 5 6 7 8 9 10
Goal-oriented	work steadfastly toward a goal	1 2 3 4 5 6 7 8 9 10
Problem-solver	think of solutions to problems	1 2 3 4 5 6 7 8 9 10
Drive	desire to work hard	1 2 3 4 5 6 7 8 9 10
Optimism	positive attitude	1 2 3 4 5 6 7 8 9 10

Date\_\_\_\_\_

Total Score\_\_\_\_\_

Your score is an indication of the extent to which you possess personal characteristics similar to those of successful entrepreneurs.

## The Probability of Your Entrepreneurial Success

### **A Score of 160-200**

You possess very strong entrepreneurial characteristics. You will probably find entrepreneurship a very desirable, exciting and fulfilling way of life.

### **A Score of 120-159**

You are mildly entrepreneurial. You may find entrepreneurship desirable and stimulating, but may have to develop your entrepreneurial abilities through training.

### **A Score of 120 and Below**

You will probably find entrepreneurship undesirable and difficult. You will probably be more successful working for someone else, although you can still develop your entrepreneurial abilities. So, if you are determined to start your own business, don't give up!

**Making a decision to start your own business isn't just about numbers. It's about you...your lifestyle, family, likes and dislikes, work habits, values, ethics and dreams. You need to honestly define who you are and what you want—your future depends on it!**

### Questions to ask yourself:

- ◇ Do you have the personal drive to be a successful entrepreneur?
- ◇ Are you willing to work whatever hours it takes to make your business a success?
- ◇ Are you willing to give up the perks of being an employee to invest and run your own business?
- ◇ Are you self-reliant?
- ◇ Can you work without support?
- ◇ Are you healthy?
- ◇ Do you have the physical ability to meet the needs of operating on your own?
- ◇ Can you handle stress?
- ◇ Do you have the mental ability to meet the everyday needs of operating your own business?
- ◇ Can you handle crisis situations and deadlines?
- ◇ Do you like people?
- ◇ Do you listen well?
- ◇ Do you have patience when working and interacting with others?
- ◇ Do you communicate well?
- ◇ Can you be a leader and a trainer for your staff as well as a front person for your business?
- ◇ Can you maintain a positive relationship with the people who work for you?
- ◇ Can you meet the needs of your customers?
- ◇ Do you have the ability to sell—yourself and your products and services?
- ◇ Can you afford to start your own business?
- ◇ Do you have the support of your family and friends?



- 
- ✓ Do you understand the terms of the contract?
    - Have you thoroughly read the UFOC and the franchise agreement?
    - Have you had all your questions satisfactorily answered?
    - Have the promises which the franchisor made during your discussions been included in the agreement?
    - Have you had a qualified, experienced franchise attorney review the documents?
    - Have you had a qualified, experienced accountant, familiar with franchising, review the documents?
  
  - ✓ Are the other franchisees happy with their investments?
    - Have you talked with and visited other franchisees?
    - Have you worked at a franchise location to get a better feeling if this is the right decision?
    - Have you contacted the franchise owners association and talked with the president?
    - Have you talked with the director of the franchise advisory council?
  
  - ✓ Does the franchisor have a history of litigation?
    - Are other franchisees constantly bringing lawsuits against the franchisor?
    - Is there anything about the franchisor's litigation history that causes you concern?
    - Have you discussed these concerns with the franchisor's management and the leadership of the franchisee owners association or franchisee advisory council?
  
  - ✓ Can you make enough money with this franchise? (Ask other franchisees:)
    - Are you making money with the franchise investment?
    - How long did it take you to breakeven?
    - How long before you started to make money?
    - Was the investment estimate the franchisor gave you accurate? If not, how much more money did you need?
    - Was the estimated working capital accurate? How much did you need to have and how long before you could take money out of the business to live on?
    - Is there any mistake you made in starting up the franchise that costs you money? How can I avoid the same problem?
  
  - ✓

- Does the franchisor staff attend seminars on franchising and management? Do they know about the latest changes in the industry? Are they active in trade associations for their specific industry and are they active in the International Franchise Association?
- Has the franchise been growing? Are new locations being added on a regular basis? How many locations closed in the last year? Why did they close?
- Are the sales within individual stores increasing?
- Does the franchisor have an active research and development department that introduces new products and services?
- Do the field staff act as consultants and advisors or do they act as police personnel (inspecting franchises and writing up violations, but not offering help and guidance?)

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## WHAT ARE THE KEYS TO FRANCHISE SUCCESS?

Making any business reach its full potential takes talent. If you've selected your franchise well, your franchisor will be able to help you avoid many of the mistakes new, independent start-up businesses make. Here are some keys for franchisee success.



✓ **Make sure you have enough money.**

- Determine how much you have to invest, how much you're willing to risk and how much you will need to live on for at least 12 months.
- Make sure you understand the initial investment required.
- Make a careful and rational decision about buying the franchise. Listen to your attorney and accountant and do not be pressured by the franchise salesperson.

✓ **Follow the system.**

- Franchisees often get their business up and running and then begin to change, add or modify existing products advertising, hours, services and even the quality and consistency they are licensed to deliver. This violates the franchise agreement and puts you in jeopardy of having your franchise terminated!
- By following the system, you:
  - preserve the brand
  - protect your investment and that of your fellow franchisees

✓ **Don't neglect your family and friends.**

- Be prepared to work long hours, but also make sure to budget time for your family and friends.
- Don't forget to acknowledge the sacrifices your family makes.
- Allow your family and friends to share in your new life.

✓ **Be an enthusiastic franchisee.**

- The success of any business is linked to the level of enthusiasm you bring to the job.
- Enthusiasm brings a level of excitement and energy to the operation that everyone can feel—including your customers and staff.
- Let your staff in on the fun. Acknowledge their good work with recognition or a raise.

✓ **Recruit the best and treat them with respect.**

- Good help is hard to find—great help is essential.
- To keep the good staff you've hired:
  - Rotate routine and boring jobs.
  - Be fair. Don't show favoritism.
  - Work with your staff to develop the schedule.
  - Treat your employees with respect. Don't allow employees to be disrespectful to any other employee.
  - Keep employees informed of new marketing and other promotions.
  - Removes hassles—ask employees which procedures are working and which aren't.
  - Make their workdays challenging.
  - Provide timely performance reviews and wage or salary increases.



✓ **Teach your employees.**

- In franchising, training should be continuous. Employees are your front line.
- Training classes are a good way to show your employees that they matter to you.
- Get all the training you can from the franchisor.
- Regularly train and retrain all your employees.
- Hold refresher and advanced classes on a regular basis.
- Alert your franchisor when you need additional training.
- Take advantage of every training opportunity, whether it's offered by the franchisor or by local schools, trade associations and other sources.

✓ **Give customers great service.**

- The most important thing you can do is to get everyone to smile!
- Let the customer know you're happy they chose your business.

✓ **Get involved with the community—customers like to shop in places that support them:**

- sponsor Little League team
- support a civic or youth group
- give tours of your business for school groups
- set up a kiosk at community events

✓ **Stay in touch with your franchisor and other franchisees:**

- Stay in communication with the franchisor: letters, newsletters, emails, phone calls, faxes, training classes, regional meetings, conferences and conventions
- Communicate with other franchisees by participating in the franchise owners association.

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✓ **Watch the details.**

- Success is in the pennies! If you watch your pennies, the dollars will take care of themselves.
- Minimize costs and maximize sales.
- Watch out for shrinkage (merchandise that is missing or unaccounted for).
- Work hard every day. Choose your time away from the franchise wisely.

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**NOTES**

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## NOTES

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# Chapter 5:

## Writing A Business Plan

*By Kathryn Morgan*

*What is it?*

*Why should I do one?*

*What does it look like?*

*How do I write one? Where do I begin?*

The goal of this chapter is to familiarize you with the nature of a business plan and to get you started writing your own. In other words, to remove the mystery or magic from the project and help you actually do it.

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### I: WHAT IS A BUSINESS PLAN?

**—a written description of your business, its history, what it does, who does it, who your customers are, what the finances are, what the competition is, what your plans are, perhaps what your exit strategy is.**

In other words, a good business plan ought to summarize the past, present, and future of your business as you now see it—succinctly and accurately.

#### ***Succinctly***

--this is not meant to be the great American novel. If ten words can convey your idea, don't use twenty.

#### ***Accurately***

--You and others are going to use this plan as the guideline for your business activities. Lenders may use the plan to evaluate the business. The Plan is not a public relations "puff piece" for you and others are going to rely on it. It should be solid, descriptive and factual.

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## II. WHY SHOULD I WRITE A BUSINESS PLAN?

(Unspoken, “ I don’t know how to do one and it looks like a pain in the neck!”)

***1. Because every business needs a plan.***

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### **III. WHAT DOES A BUSINESS PLAN LOOK LIKE?**

A full Business Plan is a written document about 25 to 50 pages long, though both shorter and longer versions may be used.

The Plan has several main sections.

#### ***Outline of a Business Plan:***

- **Cover sheet**

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## IV. WHERE DO I START?

### Enough talking ABOUT the Plan. Let's get going!

Do you feel more like the Cowardly Lion looking for courage or the Tin Man looking for a brain? Be brave! This isn't magic! And the hardest part may be simply getting started.

Or, as the old saying goes, "How do you eat an elephant? One bite at a time!"

Sit down and start drafting now. Some areas will require thought. Some will involve hunting through files and gathering financial documents. Some will involve research. For some you'll need to involve others in your business and that may be one of the real advantages of the whole process. Your team is thinking and planning together, building understanding and consensus.



The end result is not only an effective document that accurately pictures your business as it is. The result is also a roadmap for taking your business where you want it to be. So make this writing a group project, utilizing the best ideas and abilities of each of your people.



#### ***Cover Sheet –***

Yes, it's the cover (well, you'll probably have a piece of clear plastic over it) and it should have:

- Company name, address, & phone
- Logo or company emblem
- Your name and title (Some plans also include company officers.)
- Date
- Confidentiality statement\*

\* Simply a sentence stating that the plan is confidential, is the property of the company, and may not be duplicated without your consent.

#### ***Table of Contents –***

Do this last, although it will eventually be placed immediately after the Cover page. It will list the heading for each section and tell the page on which it begins.

#### ***Executive Summary –***

Another section ultimately found up front but one of the last sections you write. Though no section of the Plan is fluff, this is the most concentrated of the text. If the reader reads nothing else, these pages should concisely summarize your business. This section should:

- ✓ Summarize the entire Plan
- ✓ Be brief (5 pages or less)
- ✓ Describe what your company does, where, why, how
- ✓ State the Company Mission
- ✓ Indicate the competitive advantages
- ✓ Sets forth how much money is needed



### ***Description of Products or Services –***

Essential description of your business. This section expands more fully the description of the business found in the Executive Summary. As you write it, take both the customer's perspective and yours in describing your products or services.



- ✓ What do you make or sell?
- ✓ What is required in materials, manufacture, packaging?
- ✓ Is anything unique?
- ✓ Necessary equipment?
- ✓ Physical facilities?
- ✓ Challenges?
- ✓ Unique advantages?
- ✓ Intellectual property (patents, copyrights, trade secrets)?
- ✓ Distribution?
- ✓ Location?
- ✓ Who are my customers?
- ✓ Legal structure
- ✓ Legal requirements, licensing, etc?
- ✓ Future plans?

This discussion may require information about the industry type in general as well as your particular business. You can find such information in trade publications (There are specialized magazines and newsletters about everything now!), on the Internet, from trade associations, in the library.

If you are making a product, it may help to describe the process from raw materials to finished product. This flow chart approach can also help in describing distribution processes, even into foreign markets.

Any of these topics may be supported by materials, plans, or documents that can be attached to your Plan in the Appendix.

### ***Organizational Structure –***

This section describes the people in your company, its management and personnel needs as the business runs day to day. This section should include:

- ✓ an organizational chart showing reporting relationships of the owners and key employees;
- ✓ the business responsibilities of each position, including skills required;
- ✓ employees needed – education, training, abilities
- ✓ hiring and recruiting practices;
- ✓ Management Team
  - Identify the individuals now holding key positions. What are their strengths?
  - What is missing? Which positions remain to be filled?
- ✓ Describe the combined leadership abilities and other strengths of the Team as a whole
- ✓ Outside professionals needed – attorneys, accountants, etc.
  - Who now holds these positions? Additional needs?

### ***Competition-***

A discussion of your competitors is probably the last thing you want to focus on in YOUR Business Plan, but this analysis may be especially important for you in positioning your product.

- ✓ List their identities, and describe the main strengths and weakness of each.
- ✓ Their marketing focus
- ✓ Their market share
- ✓ How your business differs

### ***Marketing Plan-***

Even great businesses fail if the marketing plan is not effective. Small businesses are tempted to cut marketing and advertising expenditures – a potentially fatal mistake – but the first step is a Plan.

#### **1. Define the market for YOUR business.**

Who is your targeted customer? Describe him/her. Where does he go to buy your product now? What does he want in it? What does he read or watch now?

#### **2. Access market research to determine marketing techniques.**

You don't have to conduct your own studies. Trade associations and business periodicals are doing that all the time for you. But now is the time to do some detective work to find out what others can tell you about your potential customers' needs and desires, and the effectiveness of old and new forms of promotion and marketing for your target market.

#### **3. Determine your pricing strategy.**

Not as simple as it sounds, this decision will be based partly on your costs, partly on your competitors' practices, partly on your niche of the market, and finally on your customers' willingness to pay.

#### **4. Describe your sales force.**

Educational background? Training? Characteristics? Compensation? Recruitment?

## 5. Establish a marketing budget.

If you are a franchisee, your franchisor may do this for you by mandating a certain percentage of your gross receipts as a contribution to a national or regional advertising fund.

Other systems do not require such contributions, but advise their franchisees to spend a certain amount in marketing.

If neither applies to you, some business writers advise spending about 5% of your annual revenues on these activities.

Don't forget to plan to use the free promotional media as well – Newsletters, press releases, etc.

## ***Financial Documents–***

Some of the readers of your Business Plan will read the Executive Summary and then skip straight to these pages of numbers. They may seem dry, but to those involved with your financial needs, they tell a significant part of your story. For these documents, you will probably need the involvement of your accountant.

The set of financials required in this section of your Business Plan may include:



- ✓ Start-up costs
- ✓ Operating costs
- ✓ Sales Forecasts
- ✓ Cash Flow Projections
- ✓ Break-even analysis
- ✓ Profit and Loss Statement \*
- ✓ Balance Sheet\*
- ✓ Cash Flow Statement\*

*\*For an existing business, these last three documents may be enough.*

These are terms which may not be familiar so let's define some of them:

**Balance sheet: a summary of the assets and liabilities of your company on a specific day.**

- This shows the financial strength of your business on a given day, often at the end of an accounting period.
- Always has three sections: assets, liabilities, and net worth ("Owner Equity")

**Profit and Loss Statement: summarizes your business's finances over time, usually a year.**

- Document that shows actual sales and expenditures over the year (or shorter period) covered.
- One of the most effective tools in analyzing your business.
- Headings include:

- Income – Net sales; Cost of goods sold; Gross Profit
  - Expenses – Variable expenses (relate to selling); Fixed expenses (administrative & overhead)
  - Net income from operations – Gross profit minus fixed and variable expenses.
  - Net profit (loss) before income taxes (includes interest income and deducts interest expense)
  - Net profit (loss) after income taxes –the “bottom line”.
- This document can show if the company is making money.



**Cash Flow Statement: projects when cash will be received and when paid out.**

- like your personal budget
- shows if the company has the cash on hand to meet its needs
- prepared for a month

When a business is starting out, projections will be required. A word of warning: *Don't get carried away by your own enthusiasm as you make projections.*

Others may rely on them and hold you to them.

Lenders and Boards of Directors can be tough on officers who don't make their projections. So be conservative as you forecast sales and fight the tendency to underestimate your expenses.

**Appendix-**

This is the section in which you can add related documents, site plans, market research, resumes, etc. The section does not have to be used at all, but if it is, list the included items under the “Appendix” heading in the Table of Contents.

**CONCLUSION-**

Have you started a draft plan of your own yet? There will never be a better time!

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## REVIEW QUIZ

Match term on left with relevant definition on right:

- |                                  |   |
|----------------------------------|---|
| 1. Cash Flow Statement           | a. Essential description of business                              |
| 2. Executive Summary             | b. Describes the people running the business                      |
| 3. Marketing Plan                | c. Optional related documents                                     |
| 4. Products/Services Description | d. Shows the financial strength of your business on a given day   |
| 5. Organizational Structure      | e. Brief overview of entire plan                                  |
| 6. Appendix                      | f. Shows actual income and expense for a year & “the bottom line” |
| 7. Profit & Loss Statement       | g. Monthly summary of \$ rec'd and paid, like your budget         |
| 8. Balance Sheet                 | h. Includes pricing and promotional policies                      |

(ANSWERS: 1-g; 2-e; 3-h; 4-a; 5-b; 6-c; 7-f; 8-d)

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## NOTES