Generating and protecting business ideas

Business Link, the government organisation set up to help small businesses, suggests that each business idea needs to be checked out against a number of criteria.

- What can the would-be entrepreneur bring to the business in terms of relevant experience and expertise?
- Is there a market for the product? Does it serve a need and will customers pay for it?
- How big is the market and how can it be reached?
- What will be the main competitors in the market?
- Is there something special about the idea? Or will it be a similar product to what is already in the market place?
- How will the business be funded?
- What are the risks involved and what can go wrong?

Franchises

Starting up your own business carries a lot of risk. Most new start-ups have ceased to exist after five years of trading. One way of possibly reducing this risk is to buy a FRANCHISE. The franchisor is a company which owns the franchise. It has a track record of running a successful business operation. It allows another business, the franchisee, to use its business ideas and methods in return for a variety of fees. In the UK, there are a large number of franchise operations including Dairy Crest, Domino’s Pizza, Dyno-Rod, McDonald’s, Subway and Tumble Tots.

The franchisor provides a variety of services to its franchisees.
- It gives the franchisee a licence to make a product which is already tried and tested in the market place. This could be a physical product but is far more likely to be a service.
- The franchisor provides a recognised brand name which customers should recognise and trust. This helps generate sales from the moment the franchise starts trading.
- The franchisor will provide a start-up package. This will include help and advice about setting up the business. The franchisor might provide the equipment to start the business. It might help find a bank which will lend money. It will provide training for the new franchisee.
- Many franchises provide materials to use to make the product. A company like McDonald’s, for example, sells food ingredients to its franchisees. If the franchisor doesn’t directly sell to the franchisee, it might organise bulk-buy deals with suppliers to cut costs for all its franchise operation.
- It is likely to provide marketing support. For example, it might have national advertising campaigns. It may provide marketing materials like posters to place in business premises or leaflets to circulate to customers.
- There should be ongoing training. This will be linked to issues such as maintaining standards, sales and new products.
- There is likely to be a range of business services available at competitive prices. For example, the franchisor might negotiate good deals on business insurance or vehicle leasing with suppliers.
- Many franchises operate exclusive area contracts. This is where one franchisee is guaranteed that no franchise deal will be signed with another franchisee to operate in a particular geographical area. This prevents competition between franchisees and so helps sales.
- Over time, the brand should be developed by the franchisor. For example, new products should be developed to appeal to customers.

In return for these services, the franchisee has to pay a variety of fees.
- There will be an initial start-up fee. Part of this will cover the costs of the franchisor in giving advice or perhaps providing equipment. Part of it will be a payment to use the franchise name.
- Most franchisors charge a percentage of sales for ongoing management services and the ongoing right to use the brand name.
- Franchisors will also make profit on the supplies they sell directly to their franchisees.
- There may also be one-off fees charged for management services such as training.

The benefits and costs for franchisors and franchisees

There are a variety of benefits and costs to both franchisors and franchisees of the franchise model.

Benefits to franchisees For the franchisee, franchising could be a relatively safe way to start a business. Partly this is because the franchisor has vetted potential franchisees and rejected applications from individuals it thinks will fail. Partly this is because the franchise already has a successful business formula which has succeeded in the past. So the new franchisee has only had to copy the performance of others. The cost of setting up the franchise is predictable. Too many start-ups have grossly over-optimistic forecasts of how little they can spend to get the business up and running on a sound financial footing. The franchisor also provides ongoing support and will provide help to franchisees which are underperforming.

Costs to franchisees Franchisees have to pay a variety of fees to the franchisor. These costs vary from franchise to franchise but franchisees are likely to lose at least 10 per cent of their revenues. This can have a significant impact on profit margins. Franchisees are locked into contracts. If they fail to keep to the contract, they can lose the franchise and as a result lose most, if not all, of their investment in the business. In some cases, contracts allow franchisees to take away a franchise without any compensation simply because it is in their commercial interests to do so.

Benefits to franchisors Many businesses are highly successful. But they find it difficult to expand because of finance and control. Finance is a problem because banks are not always
Question 2.

Domino’s Pizza is a highly successful worldwide franchise operation. It provides a pizza delivery service, taking pizzas to your door. In the UK, in 2008 it had over 500 outlets owned by franchisees.

According to www.whichfranchise.com, franchisees pay a royalty to the franchisee of 5.5 per cent on sales plus 5 per cent of sales to pay into a national advertising fund. The minimum initial investment to open a single store for a franchisee is £240,000 + VAT. However, for this initial investment, Domino’s Pizza provides all the equipment needed and finds premises. New franchisees are given three weeks initial training (the Franchise Development Programme) and further training on an ongoing basis. The brand is supported by national advertising campaigns. In recent years, this has included sponsoring The Simpsons on television. Franchisees are monitored for quality of service by the franchisee.

Antony Tagliamonti is a franchisee who now owns three outlets. He says: ‘I never got bored and, even after ten years, I am still finding new ways of operating, recruiting team members, increasing sales and pushing the business forward.’


(a) What is the difference between a franchisor and a franchisee?
(b) What might be the advantages and disadvantages to an entrepreneur of buying a Domino’s Pizza franchise rather than setting up their own pizza delivery service?
(c) What might be the advantages to the American company which owns the Domino’s Pizza franchise of using a business franchise model?

Costs to franchisees. In successful franchises, some of the profit goes to the franchisee. The franchisor, therefore, might have been better off with a traditional business expansion model rather than turning the business into a franchise operation. Running a franchise can increase costs because franchisees have to be supported in various ways. Franchisees can also be a problem. Some franchisees will fail to work hard enough or show sufficient business skills. Their franchises will underperform or fail and this will hit the profits of the franchisor. Other franchisees will not operate according to the franchise formula. For example, if it is a fast food franchise, some franchisees might cut costs by not cleaning the premises sufficiently and not keeping the furniture and décor in good condition. This could tarnish the brand image of the whole chain of franchises.

Franchising associations claim that franchising is a much safer business model for an entrepreneur than opening their own business. They claim the failure rate for franchisees is much lower than for other business start-ups. Some academic research, however, suggests that franchisees, if anything, are more likely to fail than if they set up independently. This is mainly because the cost base of franchisees is higher since they have to pay a percentage of their sales to the franchisor.

Successful franchises are ones where being a franchisee generates substantially more sales than if the business were independent.

Trademark, copyright and patents

Every business has a name which is crucial to its business success. If another business starts using your business name to sell the same goods or services in the same markets, then you may be able to sue them and stop them using your business name. Businesses can further protect their name, or the names of their products, by registering them as a TRADE MARK. In the UK, this is done by registering them with the Intellectual Property Office (UK-IPO). Other businesses are then not allowed in law to use that trademark name. Trademark protection can also be applied to signs, symbols, logos, words, sounds or music.

Business start-ups should also think about whether they want an Internet domain name (i.e. a web address). Unique domain names can be registered so that no one else can use that address. For example, no one can use www.tesco.com because it has already been registered by Tesco, the supermarket chain. Common popular names are likely to have been taken already. So a start-up business might have to use a less obvious name for their web address.

A small number of business start-ups are linked to selling a new, innovative product which can be protected through copyright and patents. COPYRIGHT is given for original artistic works such as music, films, photographs, plays and books. PATENTS are given for inventions. Both copyrights and patents have to be registered with the Intellectual Property Office.

Trademarks, copyrights and patents aren’t just there to protect a business from others copying their ideas. They can be prepared to lend for growth. Even if they do, it might be too little money to take the business in the right direction. Control is a problem because employees don’t necessarily have the same motivation for success as the entrepreneur who founded the business. A franchise model is one way of getting round these problems. Finance for growth comes from franchisees who pay most of the cost of expanding the business. Franchisees also have the motivation to succeed. The franchisor is harnessing the skills and enthusiasm of another entrepreneur, the franchisee. Another benefit to the franchisor is that it reduces risks from failure. If the franchise proves a failure, much of the cost is borne by the franchisee rather than the franchisor.