being the most frequent causes of business failures, it is reasonable to conclude that the selected candidates would have experienced a lower than average failure rate, with or without a franchise.

Success and survival

Furthermore, is the rate of survival the only criteria for measuring business success? Obviously not!

The purchase of a franchise is an investment, and therefore should be subjected by the would-be entrepreneur to the same evaluation criteria as any other investment, namely return on investment (ROI).

In spite of the maxim claiming that if it is edible, drinkable, wearable or thinkable, it is franchisable, one must qualify this to include that a franchise can only be successful if the profit from the operation is large enough to be shared, as both the franchisor and the franchisee will be "nourished from the same pie".

The fundamental question remains whether the reduction of risk in the purchase of a franchise is worth the investment.

Although one cannot dispute the evidence that several fortunes have been made in franchising, it should be noted that the big money usually goes to those who dream up the idea in the first place. However, how many franchisees have been lured by such success stories in buying a franchise and for all practical purposes have been buying a dream?

As previously stated, it should be realized that a franchise opportunity is nothing more or nothing less than a business proposition and should be evaluated objectively by assessing both the costs and the benefits to be derived.

Because of the wide range in available franchises from the standpoint of costs and benefits, it is impossible to propose conclusions applicable to all. Consequently, it will be interesting to take a look at the two extremes of the franchise spectrum. Conclusions will apply in varying degrees, depending on the position of each individual franchise on this spectrum.

Few failures

The first type of franchise consists of the top tier franchises offering a widely recognized format proven successful over a period of time, in a variety of geographic areas. It provides the benefits of consumer acceptance, national advertising and exposure, and other benefits related to belonging to a large organization.

Although no franchise offers a guarantee of success, business failure with this type of franchise is generally very low as the franchisor maintains a high degree of control. Unfortunately, since at that point the franchisor is generally financially successful, the franchisees, in certain instances, tend to be considered a disposable entity and risk becoming so especially at renewal time. In addition, as the format became popular, the franchise fee went up in price.

Coupled with the fact that most new franchises will be set up in secondary markets due to the proliferation of points of sales, therefore not only limiting the potential for revenues, but also opportunities for future growth, these factors will contribute to adversely affect the potential ROI.

It should be understood that the franchisor's interest is best served through the maximization of sales by each establishment as he collects sometimes up to 15 to 20 per cent of sales as rental, royalty and advertising revenues.

From the franchisee's standpoint, maximization of profit is obviously the predominant objective. This serious difference in objectives might result in a conflict as the franchisor is pressed into maintaining an established growth rate in earnings.

This conflict generally takes the form of retail price-setting pressure.

"The franchisees tend to be considered a disposable entity and risk becoming so especially at renewal time."

Although franchisors cannot legally control the product selling price of their franchisees, they have resorted to franchisor-owned point of sales to exercise this pressure; this is especially effective when franchisor-owned point of sales are scattered among franchised outlets. This is a major contributing factor to the increasing number of franchisor-owned point of sales, now reaching about 28 to 30 per cent of the total number of licenced establishments, with many franchisors aiming at a 50 per cent proportion.

These factors can directly and adversely affect the financial returns that can be derived from owning a high-profile franchise.

Greater ROI rewards

The other end of the spectrum is represented by the new developing franchise. This situation could lead to greater rewards in terms of ROI as it could involve the acquisition of a large territory, sometimes regional, along with other concessions from the franchisor, but it also represents a much higher risk than in the first instance in that it could literally result in the money of the franchisee being taken away.

An important element of this risk lies in the fact that the product or service tested and presumably found workable on a limited scale elsewhere, might not prove successful in the franchisee's particular market where consumer behaviour might be different.

An illustration of this is the well-documented situation with tacos, the product having experienced a phenomenal acceptance rate in those states bordering Mexico but severe market resistance farther north. In addition, in such an instance, the franchisor has little at stake and consequently will show little involvement and supply limited assistance.

Since the would-be entrepreneur is primarily seeking to reduce risk when considering a franchise, under this situation, he could only expect to gain very few of the potential benefits of owning a franchise; consequently, this avenue should only be considered by the more aggressive would-be entrepreneurs.

A franchise does not constitute the perfect business arrangement unless an even balance of dependency exists between the parties. A would-be entrepreneur would therefore be well advised, in addition to searching for an attractive franchise, to consider the purchase of an existing enterprise as this could, from a risk level or on a ROI basis, prove to be an attractive alternative.

In addition to greater independence, the latter offers potential advantages over the acquisition of a franchise as it could, at the outset, result in a lower initial investment through the possible acquisition of fixed assets at a price below replacement costs and arrangement of advantageous financing in the form of a balance of sale at preferential interest rate from the vendor.

Secondly, a higher profitability could be experienced since there would be no payment of royalties and no territorial restrictions on the possibilities of expansion nor any time limits.

A third benefit could be the reduction of risk resulting from the possible appraisal of the acceptance by the local consumers of the product or service offered.

Consequently, the payment of any goodwill, which is effectively what a franchise fee represents, would be based on actual profits or potential and not solely on the franchisor's projections based on past performance of other points of sales whose situation might differ.

Furthermore, in most instances, the sought know-how will be available either through an existing organization or the retaining of the former owner for a period of time and finally, if the format of the acquired enterprise is successful, who knows, it might even be franchised! ■

This article has been reprinted with the permission of the Canadian Bankers Association. It originally appeared in the association's journal, the Canadian Banker. The author, Albert Gadbois, is professor of small business management at the University of Moncton, and is president of Moncton Consulting Services Limited.