** COMSATS University Islamabad, Virtual Campus**

 **MGT403**

 **Entrepreneurship**

 **Lecture 19 Handouts**

**Myths & Tips about Franchising**

**Ten Myths of Franchising**

1. **Franchising is the safest way to go into business because franchises never fail**. Franchises have got the better chance of success but there is no absolute guarantee that it is going to be successful.
2. **I’ll be able to open my franchise for less money than the franchiser estimates**. Launching a business, including a franchise, normally takes more money and more time than entrepreneurs estimate.
3. **The bigger the franchise organization, the more successful I’ll be**. Bigger is not always better in the franchise business. Some of the largest franchise operations are struggling to maintain their growth rates because the best locations are already taken and their markets have become saturated.
4. **I’ll use 80 percent of the franchisor’s business system, but I’ll improve on it by substituting my experience and know-how.** When franchisees buy a franchise, they are buying, in essence, the franchisor’s experience and knowledge.
5. **All franchises are basically the same**. Each franchise has its own unique personality, requirements, procedures, and culture. Naturally, some will suit you better than others.
6. **I don’t have to be a hands-on manager**. I can be an absentee owner and still be very successful: Most franchisors shy away from absentee owners, and some simply do not allow them in their systems at all.
7. **Anyone can be a satisfied, successful franchise owner**. With more than 3,000 franchises available, the odds of finding a franchise that appeals to your tastes are high.
8. **Franchising is the cheapest way to get into business for yourself**. Franchisors look for candidates who are on solid financial footing.
9. **The franchisor will solve my business problems for me; after all, that’s why I pay an ongoing royalty.** Although franchisors offer franchisees start-up and ongoing training programs, they will not run their franchisees’ businesses for them.
10. **Once I open my franchise, I’ll be able to run things the way I want to**. Franchisees are not free to run their businesses as they see fit. Every franchisee signs a contract that requires him or her to run the business according to the franchisor’s requirements.

**Detecting Dishonest Franchisers**

* Claims that the contract is “standard; no need to read it.”
* Marginally successful prototype or no prototype.
* Poorly prepared operations manual.
* Promises of future earnings with no documentation.
* High franchisee turnover or termination rate.
* Unusual amount of litigation by franchisees.
* Attempts to discourage your attorney from evaluating the contract before signing it.
* No written documentation.
* A high-pressure sale.
* “Get rich quick” schemes, promising huge profits with minimal effort.
* Reluctance to provide a list of existing franchisees.
* Evasive, vague answers to your questions.

**The Right Way to Buy a Franchise**

The best defenses a prospective entrepreneur has against unscrupulous franchisors are preparation, common sense, and patience. The steps discussed below will help you to make the right choice.

* **Evaluate yourself - What do you like and dislike?** Before looking at any franchise, entrepreneurs should study their own traits, goals, experience, likes, dislikes, risk orientation, income requirements, time and family commitments, and other characteristics.
* **Research your market.** Before shopping for a franchise, research the market in the area you plan to serve. How fast is the overall area growing? In which areas is that growth occurring fastest? How many competitors already operate in the area? How strong is the competition? Investing some time to develop a profile of the customers in your target area is essential; otherwise, you will be flying blind.
* **Consider your franchise options.** Small business magazines devote at least one issue to franchising in which they often list hundreds of franchises. These guides can help you find a suitable franchise within your price range. The Internet is another valuable tool for gathering information on franchises.
* **Talk to existing franchisees**. The best way to evaluate the reputation of a franchisor is visit several franchise owners who have been in business at least one year and interview them about the positive and the negative features of the agreement and whether the franchisor delivered on its promises.
* **Ask the franchiser some tough questions.** Take the time to ask the franchisor questions about the company and its relationship with its franchisees.
* **Make your choice.** Once you have done your research, you can make an informed choice about which franchise is right for you.

**Financial Reporting**

* Common mistake among business owners: Failing to collect and analyze basic financial data.
* One-third of entrepreneurs run their companies without any kind of financial plan.
* Only 11 percent of business owners analyze their companies’ financial statements as part of the managerial planning process.
* Financial planning is essential to running a successful business and is not that difficult!

**Basic Financial Reports**

**Balance Sheet -** A financial statement that provides a snapshot of a business’s financial position, estimating its worth on a given date; it is built on the fundamental accounting.

Equation: Assets = Liabilities + Owner’s equity

Assets - Items of value owned or controlled by the business that contributes towards generating revenue.

Liabilities- Liabilities are the financial obligations or debts of the business and include claims that creditors.

Capital - Equity includes the initial and ongoing capital investments made by the owners, retained earnings (or accumulated losses), and reserves.

**Income Statement** – “Moving picture.” Compares the firm’s expenses against its revenue over a period of time to show its net income (or loss):

Net Income = Sales Revenue - Expenses

Revenue – which we are getting through sales

Expenses – include utility expenses, salaries, rent, interest and subsequently taxation as well.

**Projected Financial Statements – Mistakes**

* **Stating “These are Conservative”**

99% of entrepreneurs say that their financial projections are conservative, but many sources say that 50% of startups fail within the first 5 years of business.  No one would start a business if their financial projections showed that they would go bankrupt in 5 years, and yet 50% of businesses go out of business.  This means that for many of you, your financials are not conservative at all.

* **No Assumptions Listed**

Another mistake that many business owners make is that they do not include their assumptions with their projections.  When you create a set of financial projections you are making dozens of assumptions.

* **No Scenario**

You should build your financial spreadsheet model in such a way that you can analyze various scenarios.

* **Assumptions Not Based on Data**

Another assumption based mistake that many entrepreneurs make is creating assumptions that are not based on data.

* **No Written Explanation**

Many times, a set of financial projections includes a profit and loss statement, cash flow statement and a projected balance sheet, but there is no written narrative that explains and justifies the projections.

* **No Bad Debt Expense**

Business owners commonly exclude bad debt expense from their budget. This is an important consideration, and failing to include this line item in your forecast can be a warning sign for potential investors.

* **Excluding Loan Payments**

This is probably the worst mistake you can make on your loan application, forgetting to include your loan payment in your financial projections.  If you are applying for a loan, you should estimate the interest rate, amount, and length of loan to come up with a projected monthly payment.

* **Excluding Taxes**

Taxes can be a huge expense for a profitable company.  Depending on where you are and your corporate structure you might expect to pay 25% or more in taxes.

* **Excluding Depreciation**

Depreciation is a non-cash expense, but it is an expense nevertheless.  Many of your assets will decrease in value each year, and will need to be replaced eventually.  Including depreciation expense in your financial projections demonstrates that you are thinking long term about the business.

* **No Breakeven Analysis**

When you create a breakeven analysis, you are determining how many units you must sell in order to breakeven, in other words your revenue and expenses are equal.  A breakeven analysis can help you determine how many units you must sell each day, month, and year.

* **Excluding Founder Salary**

If you want to operate a sustainable business, then at some point you need to take home a salary as the owner.  If your projections never include a salary for yourself, your investors are going to recognize that you can’t continue to operate this way forever.

**Breakeven Analysis**

* The breakeven point is the level of operation at which a business neither earns a profit nor incurs a loss.
* It is a useful planning tool because it shows entrepreneurs minimum level of activity required to stay in business.
* With one change in the breakeven calculation, an entrepreneur can also determine the sales volume required to reach a particular profit target.

**Calculating the Breakeven Point**

**Step 1.** Determine the expenses the business can expect to incur.

**Step 2.** Categorize the expenses in step 1 into fixed expenses and variable expenses.

**Step 3.** Calculate the ratio of variable expenses to net sales. Then compute the contribution margin:

$Contribution Margin=1-variable expenses/Net Sales Estimate$

**Step 4.** Compute the breakeven point

$$Breakeven Point=\frac{Total fixed costs}{Contribution Margin}$$