



NatWest bfa Franchise Survey 2011



produced by



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1. Background

This year we report on the 27th year of the annual franchisee and franchisor survey commissioned by the British Franchise Association and sponsored by NatWest bank.

Primary research with both franchisees and franchisors was conducted between December 2010 and February 2011 this year. Conducting the consultation at the end of the year allows survey respondents to comment on their activity for the 2010 calendar year. Survey data has been supplemented with other franchise industry experts and statistical sources where appropriate.

Interviews amongst both groups were conducted using computer aided telephone interviews. Directors and managers of franchises were interviewed and owners/ partners of franchise units.

Repeating the survey on an annual basis allows us to track trends over time on key measures and as such, the majority of the interview content is unchanged year on year. This provides the overview and context of the UK franchising market, which is then supplemented by additional focus on key emerging themes. The continuing economic difficulties are a key area of scrutiny for this report.

It is important to note that although published in 2011, survey data refers to the 2010 calendar year, which is what respondents were asked to comment on.

Richard Smith, Research Director of BDRC Continental was responsible for authoring this report, with additional input and overview from Dr Crispian Tarrant, Chief Executive BDRC Group.

The publishers use their best endeavours to ensure the accuracy of the report, but do not warrant the accuracy of the data provided nor do they accept liability for any error contained in or omission from the report or any loss direct or indirect arising there from.

Note on Statistical Confidence

Much of this report is based upon the findings of survey research studies, to which statistical confidence limits apply.

Taking the 95% confidence interval the following indicative ranges apply to the survey findings:

Survey Findings At Or About

	5% / 95%	20% / 80%	50%
Franchisor survey (n=150)	+/-2%	+/-3%	+/-4%
Franchisee survey (n=330)	+/-3%	+/-5%	+/-6%

Note that the finite population correction applies to the franchisor sample. Since the sample is a substantial proportion (17%) of the population this enhances our statistical confidence in the survey findings.

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2. Management summary

This year we see franchising extending further than ever before, with a substantial increase in the number of systems in operation in the UK and a corresponding increase in the number of units. This amounts to an estimated contribution of £12.4 billion to the UK economy.

In line with this expansion, there are now reckoned to be in excess of half a million people working within the franchise industry.

There are now reckoned to be 897 franchise systems operating in the UK with a total of 36,900 units.

4 in 5 franchisees reckon that being part of a franchise has given them a competitive advantage in the last year when compared with similar businesses that are not franchised.

The recession appears to have had a limited negative impact on profitability, turnover and employment and business failure. However the slow and faltering growth in the economy is denting confidence, as amongst the wider SME business community. Pessimism in some quarters is directly linked to concerns over the impact of public spending cuts (a key market for some franchises) and the rise in VAT.

Of those franchisees in operation for less than two years, just over half came into the industry with the specific intention of starting a franchised business, rather than just any small business. This proportion has risen from less than one third in 2006 and demonstrates much greater awareness of franchising amongst the potential franchisee population.

Running costs are generally felt to have increased again in 2010 (energy costs in particular), and a higher proportion of franchises felt they had to increase their prices in 2010.

'Red tape' still takes a significant proportion of time for franchisors and franchisees, but the survey points to an easing of this burden in 2010.

Strong communications within any given franchise is strongly correlated with overall profitability. Encouragingly, in the latest survey there is evidence of good levels of contact and satisfaction with field staff and a proliferation of other communications tools including face to face contact in conferences.

As franchising develops as an industry, it is becoming increasingly more diverse in ethnicity, age and gender.

3. Franchise activity in the UK

3.1 Survey background and method

We are proud to present the results of the 27th annual NatWest/ bfa Franchise Survey. This report provides the most detailed perspective on trends and developments in the UK franchise industry, and the depth and breadth of data now available allows us to dig into trends over time. We can compare the impact of the current economic slowdown to the recession of the early 90's as well as drilling into current issues, such as the potential impacts of government spending cuts on the sector.

In order to achieve the best overview of opinion from those that matter in the franchise industry we have interviewed Franchise Development Directors (referred to throughout the report as 'Franchisors') and owners of individual franchised units ('franchisees'). Survey data is supplemented with secondary sources where applicable to build a comprehensive picture of the industry in 2010.

The NatWest/ bfa Franchise Survey is unique as a source of primary and verifiable research amongst franchisors and franchisees and is the industry's most thoroughly researched document.

The focus of the research has always been on active systems: those systems that at the time of publication are understood to be trading fully and operating at least one franchised unit (genuinely franchised rather than company owned). This definition excludes many businesses that may have announced plans to franchise, but do not currently operate any functioning (franchised) units, as well as those that have withdrawn from the franchising format, but continue to trade exclusively via company owned outlets. This definition is strictly applied when constructing the estimate of business format franchises operating in the UK and it should be noted that estimates from other sources may differ.

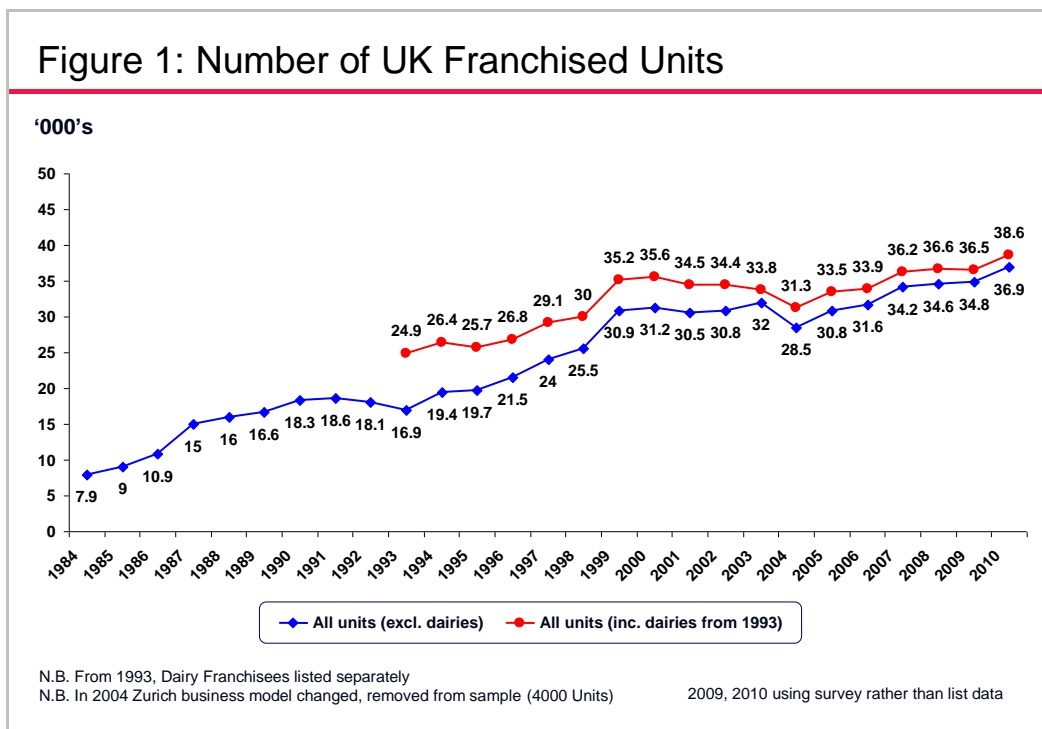
In order to measure the number of active franchise systems, various different sources are used. These include the Franchise World Directory, the UK Franchise Directory, www.franchiseinfo.co.uk, other online lists of systems known to be operating in the UK and the proprietary databases of the bfa and NatWest. From these sources and from information built up over previous years, a 'long list' is compiled. This list is then subject to intensive review by industry experts at the British Franchise Association and NatWest's Franchise Section, until all parties are satisfied that only active systems are included. The authors of this report would like to thank these sources for their assistance.

3.2 Franchise industry size

A key estimate as to the size and health of the industry is the 'total number of franchised units'. This number is not straightforward to derive, as, while some franchise systems publish their number of franchise units on websites, or provide this figure to directory compilers, a substantial proportion do not.

In previous years, we have relied solely on survey data for this figure. Last year, we added a refinement by blending survey data with database sources for the largest franchises. However, over recent years we have populated much of our sample database from survey data, to the extent that we now believe this to present a more accurate and reliable measure of the actual number of franchised units out there.

For 2010 we calculate a total of 36,900 non-dairy units, which represents an increase of 6% since 2009, largely driven by an increase in the number of systems (+7%) in current operation.



As shown in the previous chart, the number of units has increased steadily over time as the franchising model becomes more established and successful in the UK. The red line shows the total of franchised units, and includes the once large dairy franchises. As our milk purchasing habits have changed over time, so the dairy element of franchising has reduced in size relative to franchising as a whole. According to Dairy UK there are 5,000 dairy roundsmen

in the UK, of which around a third are franchised. In order to properly understand the growing part of franchising, many of the tables in this survey are reported as 'non-dairy franchises'.

Most franchised units originated as such, although a small number (3,400 – based on a three year rolling average) were converted from company owned units (managed directly), and an even smaller number (1,800) started out as independent businesses before joining a system.

3.3 Franchising in a broader context

As well as being considered to be active systems, there are other conditions for inclusion within the franchise survey:

1. Businesses must involve a trademark, a method of trading and a license to use the trademark, which all franchisees must adopt and pay for
2. The franchisee must be able to sell the business on to a third party with the benefit of the goodwill derived from developing the business over time

The additional application of these strict criteria means that there are significant sectors which contain many businesses that present characteristics of franchising and yet are not included in this survey. These include petrol station retailers, car and motorcycle dealerships, certain public houses and soft drink distributors. (As an example, Esso's retail outlets show many of the characteristics of franchising, but outlet owners are not able to sell on any goodwill at a profit.). In order to present a fully rounded picture, we summarise some key measures about these types of businesses to understand the total influence of franchise type businesses in the UK economy.

Petrol station retailers

The number of petrol filling sites in the UK fell again to 8,892 at the close of 2010 according to the Energy Institute. This represents a big decline over time (now around a quarter of the figure recorded in 1970). Sites continue to close because of strong competition between fuel retailers and the costs of environmental regulation which favour the larger sites. It is estimated that independents constitute 5,739 sites, with 1,303 supermarket sites and 1,850 Oil Company owned. Over time it is the independents which have been hardest hit by closures.

Public houses

In 2007 it was estimated that over 80% of pubs are small businesses run by tenants, lessees and owners. Closures continue in the UK Pub trade, albeit at a slower rate of 25 per week

compared to 40 per week last year. The British Beer and Pub Association (BBPA) reported a total of 1,330 closures in 2009, with an estimated net job loss of 13,000 across the country. Closures have been highest in London and the North West.

Car dealers

There are encouraging figures from the Society of Motor Manufacturers and Traders, with registrations of new cars up 1.8% in 2010 to just over 2 million, despite the closure of the 'Scrappage Scheme' in March 2010. Franchised car dealers however continue to feel the impact of the recession, with a further fall in the number of franchised car dealers to 4850 down from 5,077 in 2009 and a drop of over 1,000 sites over the past 10 years.

A small number of motorcycle dealers are exclusive to one manufacturer, and therefore similar to a franchised business. In 2009, the Motor Cycle Industry Association (MCIA) reported a drop in registrations of over 20% compared to 2008.

4. Is the recession over for franchising?

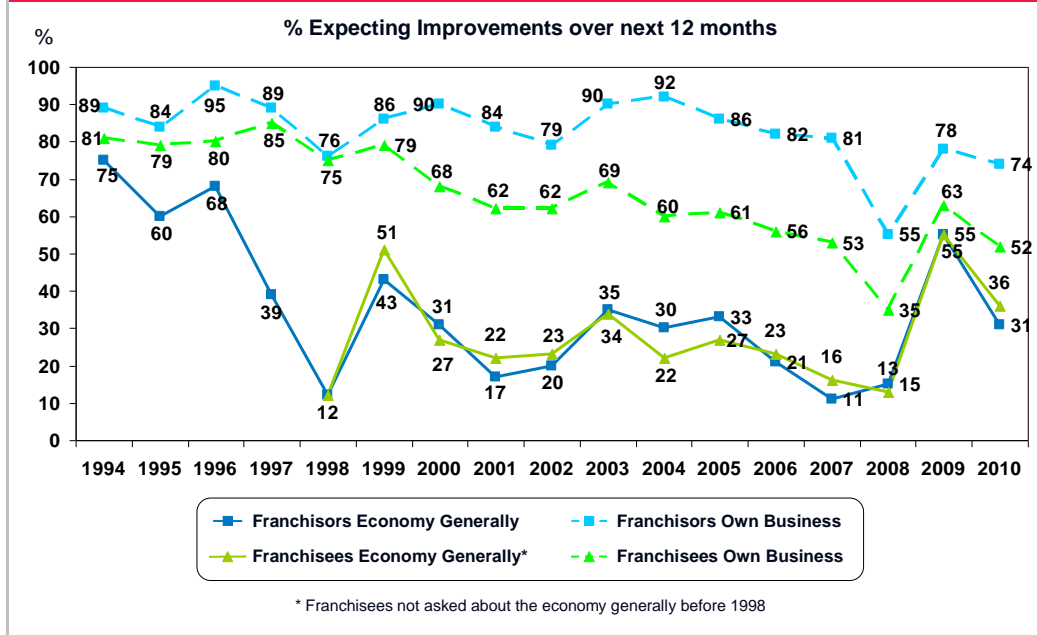
4.1 Economic outlook and confidence

In last year's report we looked at the severe impact on the franchise industry of the previous recession at the beginning of the 1990's and contrasted this with the relatively mild impact on the industry in recent years. What becomes clearer from this year's data is that these two economic 'events' are very different in shape. After a very sharp decline in profitability levels from 1990 to 1992 along with high levels of business failure, the industry picked up and began to grow steadily. This time around, there has been much less severe initial impact, however it's harder to predict what comes next in terms of 'recovery' with mixed signals from week to week and month to month.

Whilst 2010 saw a return to modest growth in the UK economy, recovery was sluggish and there was actually a slight contraction in the 4th quarter of 2010, blamed at the time on poor weather. More recently, unemployment rates have risen and growth targets have not been met. Consumer spending remains heavily squeezed and businesses and consumers alike complain that credit remains expensive and hard to come by. The combination of external inflationary pressures (fuel in particular) along with public sector spending cuts and the VAT increase make for a challenging outlook at least in the medium term.

Two years ago, in the 2009 report, despite the turmoil in the UK and global economy, this survey showed few indications of widespread business failure either at a system or unit level, although franchisors and franchisees were extremely pessimistic about the near future. Last year, we found a great deal more optimism, with most expecting improvements in the economy and their own businesses over the next 12 months. Confidence levels have once again receded this year, although only back to the levels of the middle of the past decade rather than the lows of the past couple of years. It is perhaps of note that, whilst franchisees continually rate their own prospects in line with their assessment of the economy in general, franchisors generally have much greater confidence in their own business than in the overall economy.

Figure 2: Business and Economic Confidence



Looking in more detail at the 6% of franchisors and the one in five franchisees who anticipate conditions for their own business getting worse:

- Encouragingly, amongst the franchisors in this category, reducing costs and accelerating growth are much higher up the agenda than redundancies.
- Similarly, even for those franchisees expecting tougher conditions in 2011, increasing marketing spend and growing existing clients are perceived as their most likely responses. They do want to improve productivity, but expect to achieve this via efficiencies and natural wastage rather than redundancies.

These sentiments are echoed with regard to staffing levels in the franchise industry which suggest expansion if anything during the past year. Franchisees report little or no changes in net staff turnover, with seven in ten indicating that turnover has remained the same, and amongst the remainder more saying turnover has decreased than increased. Those new to franchising (less than 2 years) are most likely to report increases in staff turnover, perhaps an indication that getting the 'right' workforce can take a while to bed in.

4.2 Projected impact of cuts and increases in VAT

Looking ahead, the authors wanted to understand the degree of exposure to the public sector in the industry as a whole and the likely impact of the cuts in public sector spending, as well as the more immediate impact of the VAT increase.

At a system level around six in ten franchises have little or no exposure to the public sector and a further two in ten rely on the public sector (directly or indirectly) for less than 30% of turnover. However at the other end of the scale around 1 in 8 franchises rely on the public sector for over 90% of sales. Naturally, at this upper level most expect to be negatively impacted by the cuts, although at an overall level three in four anticipate little or no impact.

The VAT increase is likely to affect franchisors across the board, with four in ten expecting to see a meaningful impact on their business.

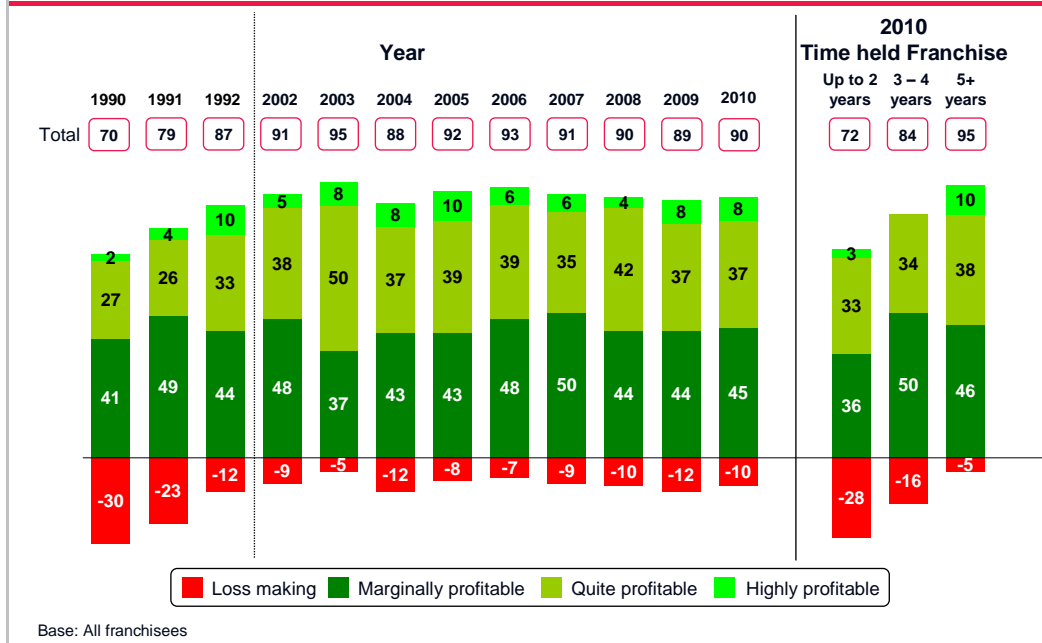
4.3 Profitability

Profitability is a key indicator of the health of the franchising industry in 2010, as here we look backwards over the actual performance of the year. A couple of years ago, when we began contrasting the impact on profitability of the most recent recession with the recession at the beginning of the 1990's it quickly became apparent that the impact on franchising this time around was less severe.

Loss making continues to account for only one in ten franchisees. However, amongst the newer franchisees it's clear that a substantial proportion is having a tough time (28%). In 2009 this proportion was 14%, in 2008, 19%, and in 2007, 12% (only slightly more than the overall average). We might hypothesise that some of the assumptions made by franchisees going into business within the last couple of years will have been severely challenged by the realities of starting to trade in a tough market.

Perceptions of profitability also show some variation between sectors, with Store Retailing and Personal Services the most likely to indicate they are making a loss (19% and 15% respectively). Certainly the non franchised retail sector has been strongly affected by the economic downturn with some big name failures and others under continuing threat. Personal services one might expect to be impacted by a reduction in discretionary spend.

Figure 3: Franchisee Claimed Unit Profitability

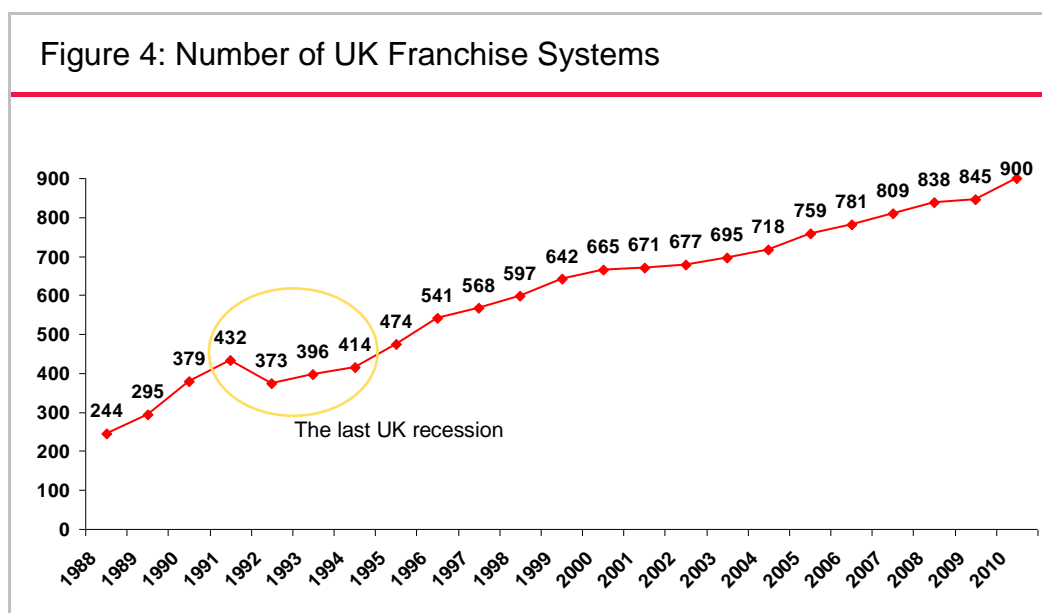


A further measure of profitability is performance over time: How did your business perform this year relative to last year? A third of franchisees report increases in profits in 2010 compared to 2009, although this is balanced by a roughly similar proportion (three in ten), saying that profits have gone down. This said, there are indications that for some at least the latter half of 2010 was more profitable than the six months prior to this.,

Franchisors are more upbeat about their economic performance in 2010 than franchisees, with 43% indicating that they were more profitable than in 2009 compared with 17% saying 'less profitable'.

4.4 An industry which continues to expand

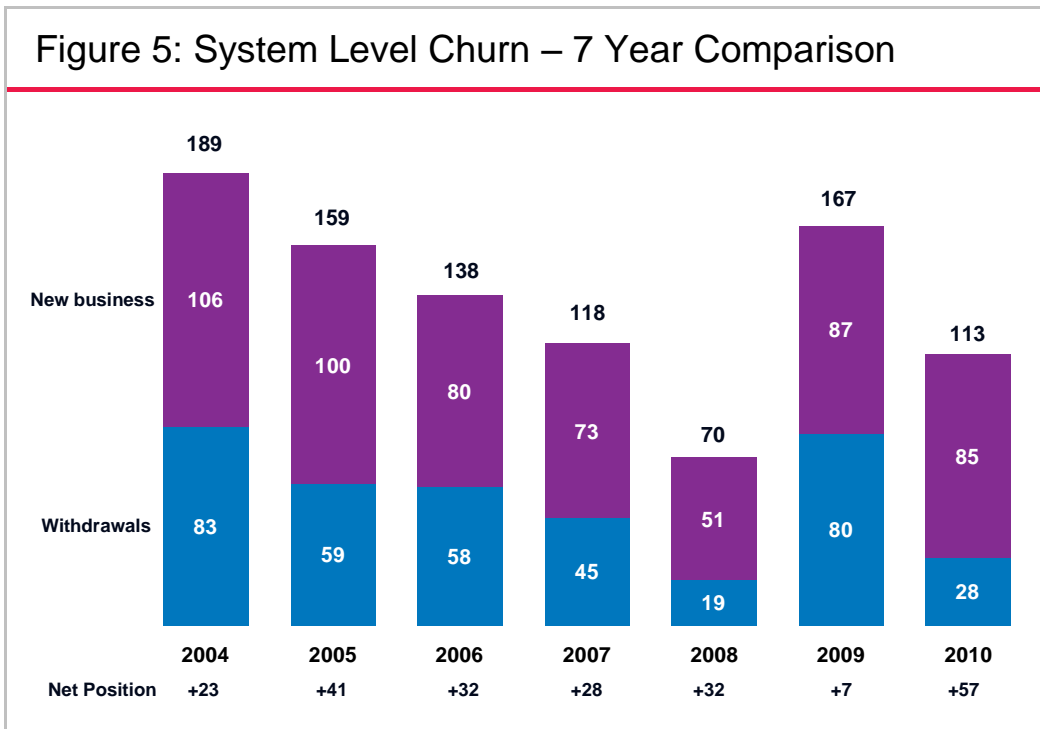
We record that there are 897 active non-dairy systems operating in the UK, compared with 842 last year. This is a significant growth and perhaps a strong indicator as to the health of the franchised business model.



Last year, churn at a system level included a significant proportion of business failure. This year, 28 franchise systems were removed from the sample list, but these were nearly all businesses that had ceased to use the franchise model, rather than business failures (at the time of going to press, we know of one franchisor failure but this company was still trading over the survey period) At the same time, the authors felt able to include an additional 85 systems which are now believed to be genuine franchised businesses.

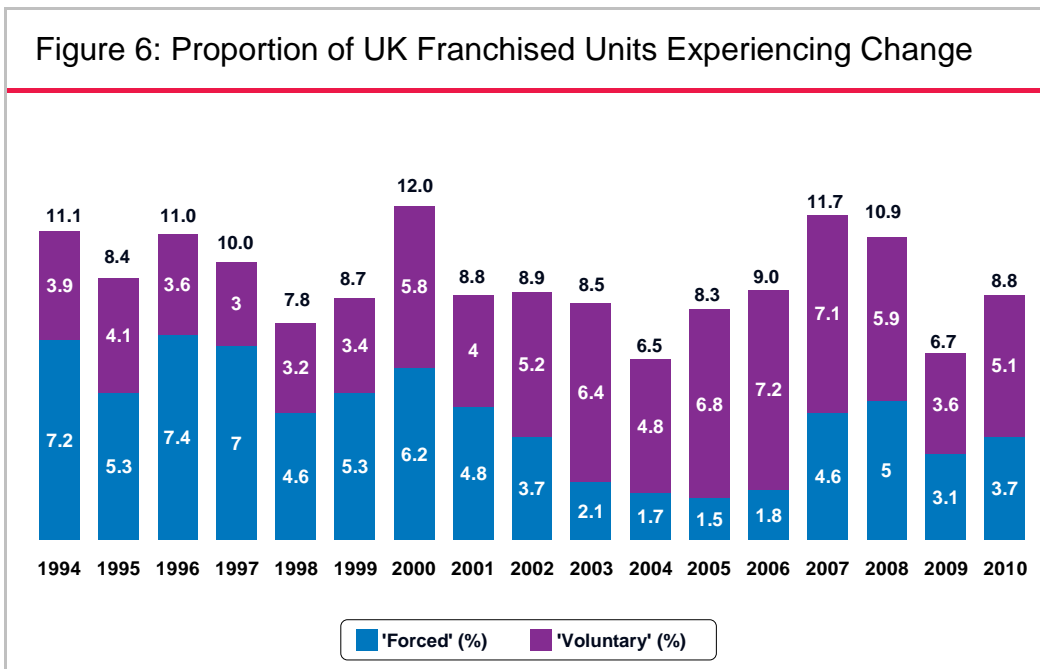
The drivers of this are not entirely clear. Adopting the franchised business model requires a considerable initial investment. However it does offer the opportunity for rapid expansion without being exposed to the levels of debt or overheads involved in owning and running multiple units. Although overall profit potential may be lower, the involvement of franchisees (rather than employees) who are fully committed to generating profit mitigates in favour of solid returns. What continued expansion of the sector does illustrate is that business owners are 'voting with their feet' after reaching the conclusion that the franchising model works!

Figure 5: System Level Churn – 7 Year Comparison



At a unit level, whilst the proportion of units experiencing change has gone up, there are still few indications of large scale business failure.

Figure 6: Proportion of UK Franchised Units Experiencing Change



There is, perhaps some indication that franchisees were feeling a little more settled about their own futures in the past year, with more making voluntary changes (5.1% to 3.6% 2009). Although this may simply be a lag from the unusually low activity the previous year, with franchisees in 2009 preferring to 'wait and see', and delaying changes.

4.5 So, what is the overall story?

Whilst confidence levels have taken a backward step from last year, profitability and turnover levels appear broadly stable, although there are concerns over new franchisees who are clearly finding it tough going. However, there are few signs of either business failure or higher levels of redundancy.

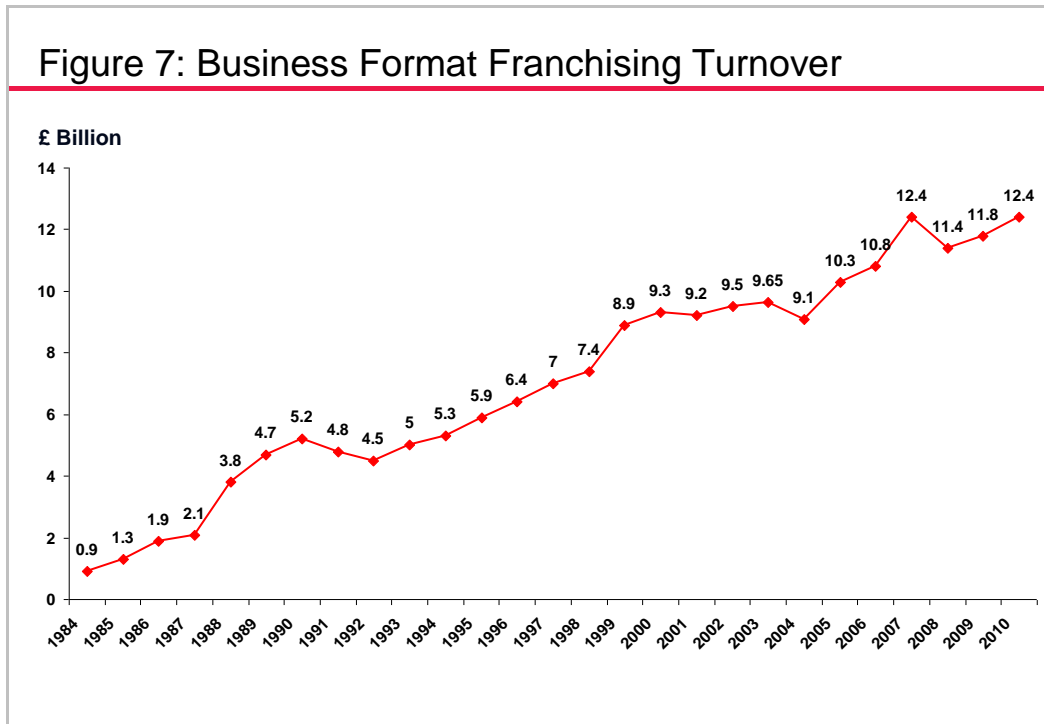
The impact on franchising of this most recent recession appears quite limited, particularly in contrast to the 1990's recession where multiple systems failed and profitability levels plummeted; it simply didn't happen this time round. These are indications of a much more robust industry, which is better able to absorb rough economic weather.

However, we are not entirely out of the woods yet. Most economists project tough economic conditions for at least the next couple of years. Continuing inflation, reduced discretionary incomes for many and austerity measures are likely to affect the franchise industry. It has shown to be extremely resilient, but it is not immune.

5. The economic contribution of franchising

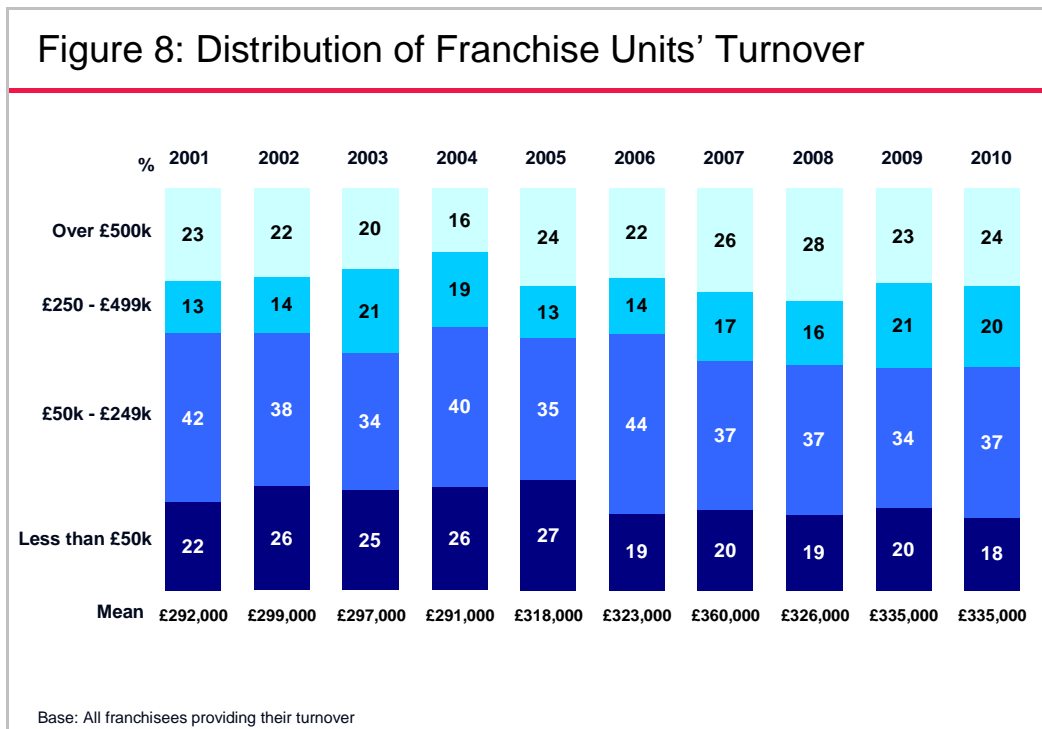
5.1 Generating wealth

The health of the franchising industry is important to the UK economy. This year the total economic contribution of franchising to the UK economy is estimated to be £12.4 billion, representing an increase of 5% since last year due to the increase in the number of systems and hence units in operation. This is back to the previous record level achieved in 2007, albeit from a larger number of systems and units.



Average franchisee turnover is calculated as £335,000 in 2010, similar to 2009, which would represent a slight decrease in real terms. Whilst the average is a useful figure for understanding the industry, it should be stressed that there are wide variations in scale and format of franchises. Therefore, few will conform to the 'average'. In short, average should not be read as 'typical'.

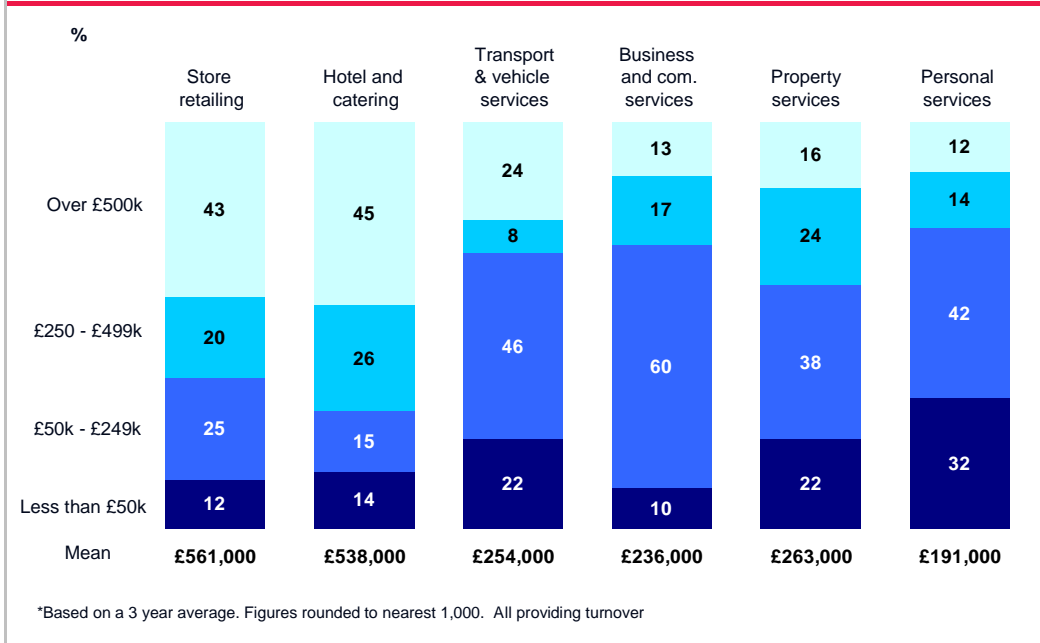
Industry statistics suggest that franchised businesses tend to be larger than SME's in general. Analysis of the distribution of turnover reveals a substantial proportion (25%) with turnovers in excess of £500k, and 44% with turnovers of over 250k which compares with 30% overall, according to ONS figures.



In order to minimise variability these sector figures are based on three year rolling averages.

Given the types of businesses operated in the Hotel and Catering Sector and Store Retailing, it is not surprising that they have on average, the highest turnover, perhaps tending to operate on a high turnover, low margin basis. Comparatively, a third (32%) of Personal Services businesses have a turnover of less than £50k and it is easy to visualise this level of turnover in, for example, a small business helping people install computers at home.

Figure 9: Annual Turnover of Franchise Units by Sector (2010 figures)

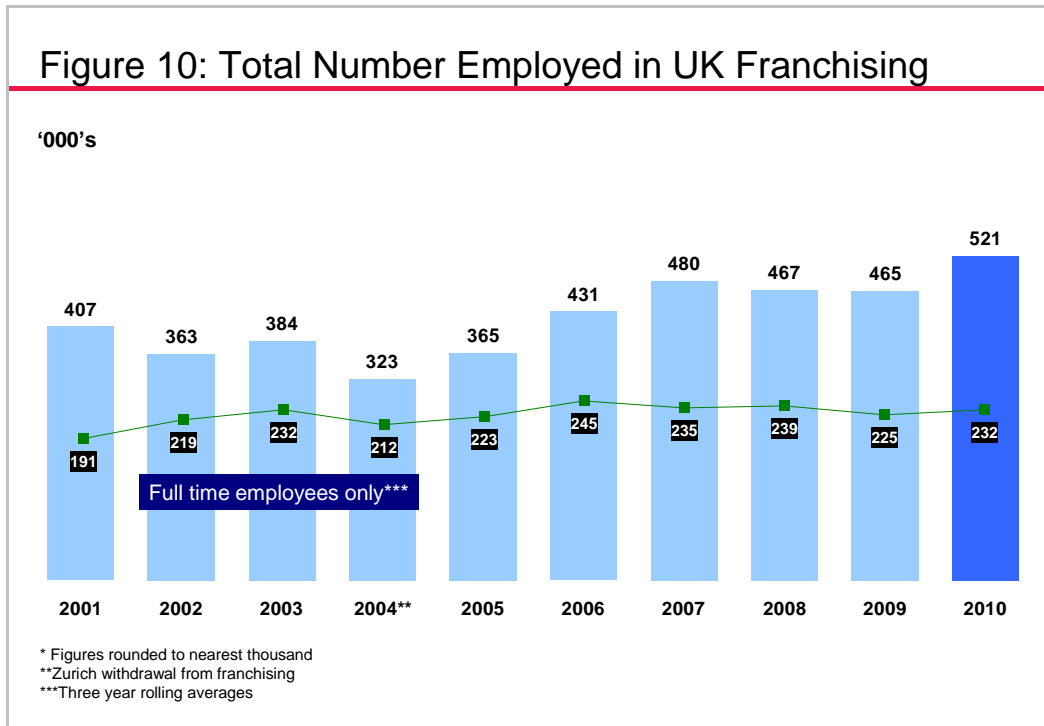


Clearly the degree to which turnover is pleasing or disappointing depends on what is expected by the franchisees, and the extent to which the figures match what they were led to expect by their franchisor. This year, a slightly smaller proportion of franchisees report that turnover was more than they were led to expect (18% vs. 24% last year), however, fewer are disappointed (27% less vs. 36% last year). On balance the majority of franchisees have their expectations met or exceeded (73%).

What is apparent here is that franchisors are being realistic with their franchisees, even in relatively tough times. There is certainly little evidence that franchisors exaggerate the potential for success.

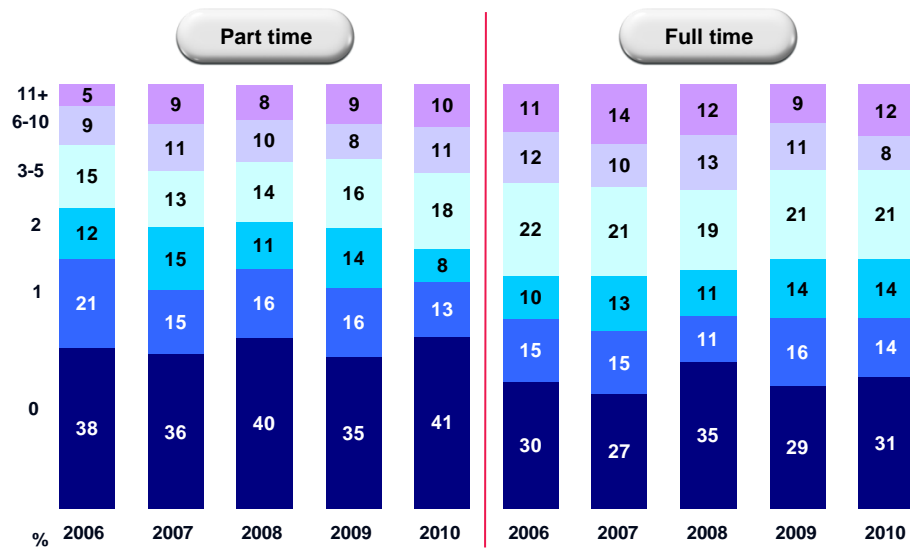
5.2 Employment in franchising

The average number of full time employees and part time employees (for franchisees) has increased slightly in 2010. Combined with our higher estimate for the number of units, we calculate a significantly higher franchise working population at over half a million (+15%), as shown in the chart below, with the increase coming mainly from part time jobs. What we can, with some certainty, draw from these results is that redundancies and staff cut backs were not extensively made in franchises in 2010.



Looking at employment in bands we can see that the survey records more franchises employing more than 11 employees. Quite a high proportion of franchises (around a third) have no full time employees, and this is relatively consistent over time. This points to the potential for the franchising industry for supporting people in effective self employment, as well as building smaller businesses.

Figure 11: Number of part time and full time employees



Base: All franchisees

Most franchisees (seven in ten) report no changes in net staff turnover, with only 16% saying this has increased in the last year. Store Retailing and Personal Services have the lowest levels of increased churn.

5.3 Franchising across the UK

With around two in three franchisor head offices based in London, South East or South West, it's perhaps not surprising that regional distribution is weighted towards these areas.

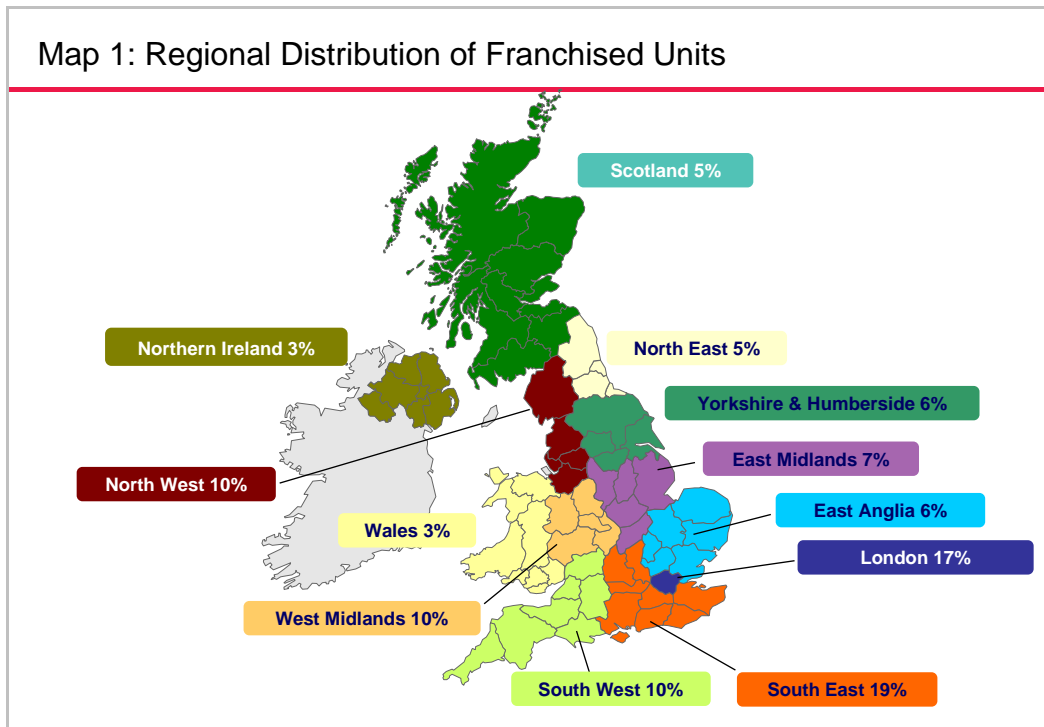
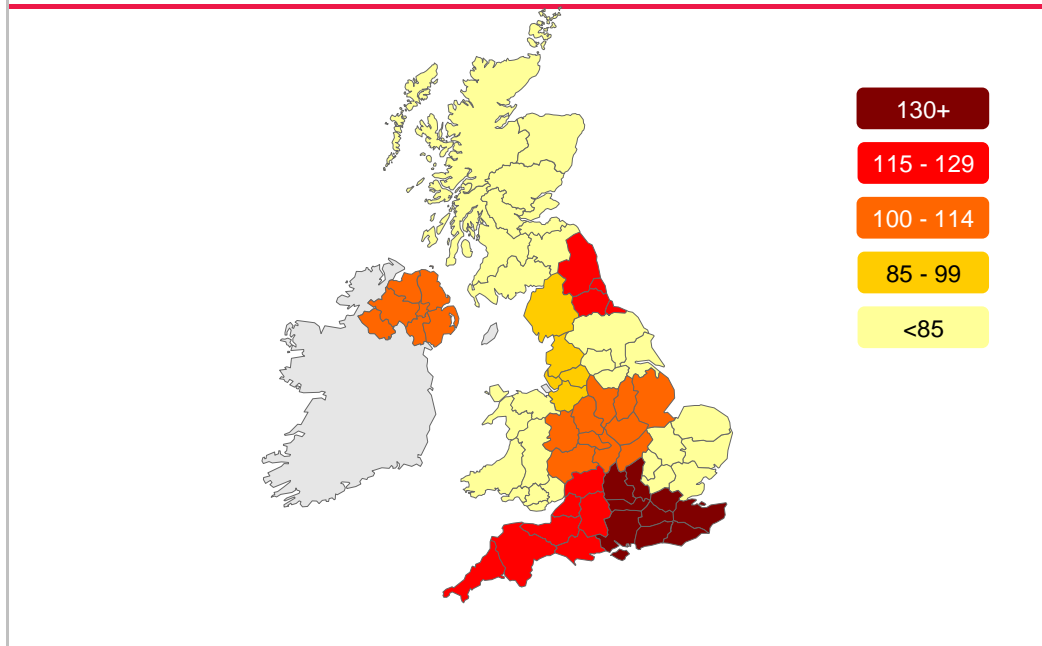


Figure 12: Regional Distribution

	Presence of All Franchise Systems in Region		Regional Distribution of Franchise Units		Implied annual Turnover from Franchising £ billion
	Total 2008-2010 %	New Systems (up to 2 years old) 2008-2010 %	Total 2008-2010 %	Indexed on UK Popn.* %	
London	74	70	17	130	2.0
Other South East	81	73	19	136	2.4
South West	72	52	10	125	1.2
East Anglia	56	33	6	67	0.7
West Midlands	69	42	10	111	1.2
East Midlands	59	34	7	100	0.9
North West	64	43	10	91	1.3
Yorkshire	55	33	6	75	0.7
North/North East	47	20	5	125	0.6
Wales	39	17	3	60	0.4
Scotland	50	29	5	63	0.6
Northern Ireland	24	9	3	100	0.3

*Indices are based on the regional spread of the UK population

Map 2: Distribution Indexed to Population



Although this map provides indications as to where the franchised model has potential for expansion, there may well be solid business reasons related to supply and demand as to why this has not happened in the past.

In recent years Regional Development Agencies and LEGI's have shown interest in developing the franchising model as a means for stimulating development in areas of deprivation, given the higher success rate of franchised businesses. Croydon, Sheffield and East of England all ran pilot projects. There is some uncertainty as to what structures will replace these agencies, however there is hope that regional organisations will continue to engage with the bfa and other bodies to promote sensible, sustainable growth.

5.4 Exporting UK franchising

Just under one in three (31%) franchisors award the master licences or control the franchising of units outside the UK as well as their UK operations. Export into international territories is as follows:

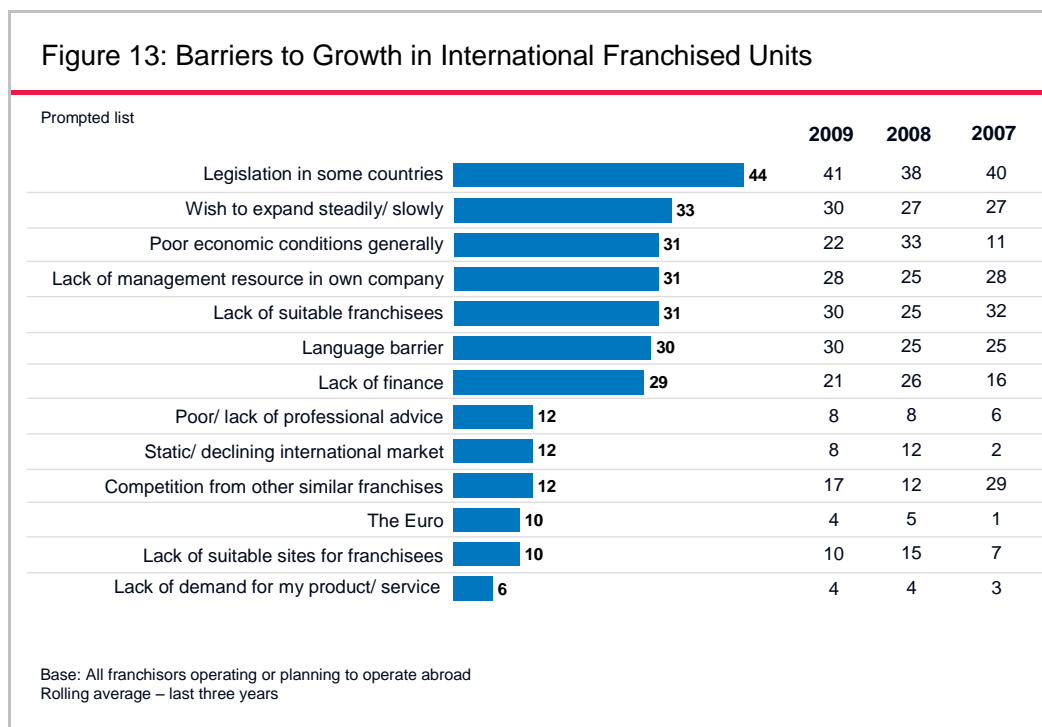
- 23% Europe (including Republic of Ireland)
- 8% US/ Canada
- 14% Other locations worldwide

Of those currently without international operations, almost two in five (38%) have plans to franchise abroad.

The most common model for those franchising abroad is to grant a master licence or licences (about two in three), although a significant proportion (about a third) direct the operation from the UK and open an overseas office (around a quarter). The model chosen will depend on the confidence and understanding of the local market and it is likely that franchisors will have different strategies depending on the market.

Legislation remains the biggest single barrier cited to franchising abroad, whether this reflects the actual experience of franchisors, or a perception, is unclear. Poor economic conditions are also mentioned as a significant barrier. Republic of Ireland and Spain are both popular as secondary markets, and both economies are currently under stress.

A number of the factors listed below relate to knowledge and expertise. These are perhaps areas that might be overcome given the right advice and assistance.



6. The structure of the Franchise industry

6.1 Franchising by industry sector

Franchised businesses are categorised into the European Franchise Federation system for classification purposes (detailed in section 7.8). This was adopted by this survey over 10 years ago and the table below shows the relative composition of the industry over time.

Figure 14: Number of UK Franchise Systems by Category

Excludes dairies

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	% Change since 2005
Hotel & Catering	116	114	113	117	112	109	108	115	125	123	127	+17%
Store Retailing	91	86	86	89	91	97	101	101	100	97	104	+7%
Personal Services	114	113	111	110	131	144	153	159	171	181	197	+37%
Property Services	125	140	147	152	165	182	189	202	205	203	215	+18%
Transport & Vehicle Services	75	76	72	76	64	66	70	73	71	68	68	+3%
Business & Commercial Services	141	140	145	152	152	158	157	156	163	170	186	+18%
TOTAL	662	666	674	692	715	756	778	806	835	842	897	+19%

The growth in franchised businesses is more pronounced in some sectors than others. Personal Services, which includes hairdressers, gyms, and beauty salons has grown by 37% since 2005, and Property Services, which includes estate agents and cleaning services has grown by 18%. These are business sectors reliant on local knowledge which still have significant proportions of small businesses rather than national chains and as such are perfect for rolling out a franchised model. Growth in other sectors is evident but at a lower pace.

We see a strong increase in our estimate of the number of franchised units this year to 36,900, and, logically, this is unrelated to the growth in the number of systems as, at 41, the average number of units per system is in line with last year. This indicates incremental growth in the size of franchises (by unit number) across the industry.

At a unit level, we can see some businesses sectors have been more affected by the recession than others. Here, the impact of the recession on Property Services is far more apparent than at a system level.

Figure 15: Number of UK Franchise Units by Category

Excludes dairies

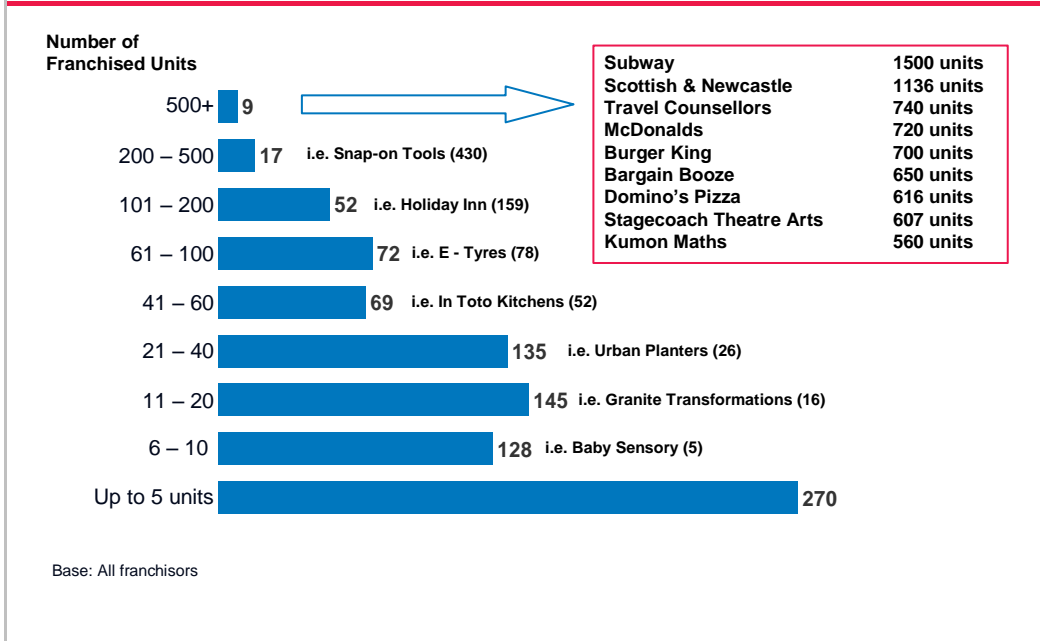
	Data from list of franchisors						Survey data (3 year rolling average) plus known franchisors (500+ units)		Data from list of franchisors
	2002	2003	2004	2005	2006	2007	2008	2009	2010
Hotel & Catering	5,800	6,395	6,380	7,050	7,450	8,100	7,000	8,200	8,400
Store Retailing	4,260	4,390	4,580	4,785	4,860	5,100	3,700	4,400	5,300
Personal Services	4,125	4,540	4,280	4,740	4,950	5,900	6,000	6,500	8,200
Property Services	5,260	5,545	6,175	6,535	6,575	6,650	8,200	7,200	6,200
Transport & Vehicle Services	2,700	2,545	2,410	2,575	2,560	2,925	2,700	2,200	2,900
Business & Commercial Services	8,650	8,590	4,740	5,075	5,205	5,525	7,000	6,300	5,900
TOTAL	30,795	32,005	28,565*	30,760	31,600	34,200	34,600	34,800	36,900

*Note: withdrawal of Zurich

In reverting to our 'long list' as the source of unit numbers, there are a number of things to note. The increase in Hotel & Catering units noted in last year's dataset appears confirmed. Store retailing appears to have been underestimated by the survey data method, and the current figure appears in line with an overall incremental upward trend. This is also true for Transport & Vehicle Services, whilst Property Service unit numbers look like they have been overestimated in recent years.

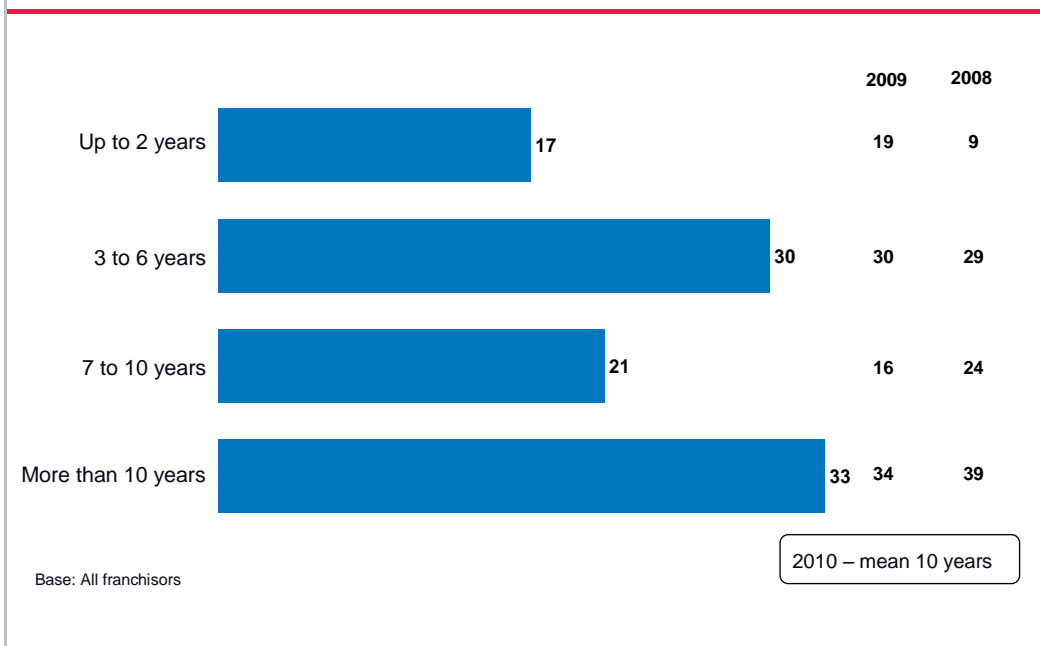
What the table above fails to communicate is the degree of variation in size of franchised businesses with regard to number of units. The following chart perhaps provides a clearer idea of distribution within the industry.

Figure 16: Scale of Systems by Unit Number



The average age for a franchise system remains 10 years, although a third of franchise systems have been in place for more than 10 years. The chart below illustrates the high number of new entrants to franchising reported earlier, with an increase in 2009 and 2010 in the proportion 'up to 2 years' old compared to 2008.

Figure 17: Average Age of UK Franchise Systems



As we would expect, systems which are most developed in terms of the number of units operated tend to be older than smaller systems (up to 20 units – 7 years, over 20 units 13 years). However, not every franchise system can be expanded as they are more specialised, whereas others can appeal to a larger market. Therefore, it is not surprising to note that almost a quarter of systems over 7 years old have fewer than 10 units.

Figure 18: Age of Systems and Number of Units (2010 figures)

	% All	% Up to 2 years	% 3 – 6 years	% 7+ years
Up to 10 units	31	57	30	23
10 - 20 units	27	36	33	20
21 – 50 units	23	5	23	29
51+ units	20	-	13	27
Average number	36 units	11 units	23 units	51 units

Figures derived from survey sample

6.2 Types of franchise system

A significant proportion of franchising businesses are run from the franchisees' home or home office. This is a further illustration of the breadth of the franchising industry, from the small, perhaps part time micro business right up to the large hotel or retail outlet.

Figure 19: Locations from where franchises operate (2010 figures)

	Franchisors		Franchisees	
	All	Excluding Store Retail and Hotels & Catering	All	Excluding Store Retail and Hotels & Catering
A home office	40%	46%	22%	34%
A shop/retail premises	25%	13%	46%	20%
An office unit	15%	20%	12%	17%
A van	9%	11%	8%	12%
A factory unit/ business park premises/ other business premises	11%	11%	12%	17%

For the half of franchises which require specific premises, one in four (27%) franchisors act as landlord to some or all of their franchisees.

Asked how they go about their business, direct selling (54%) is a key means of trading for the franchise community, more common than through a shop/ retail outlet (44%). Other channels used including websites (39%), telesales (17%), tradeshow (21%) and mail order (10%). Only two in five rely on a shop or retail outlet (44%).

Going back to when this survey began (in 1984), the majority of systems operated principally in the business to business sector. However this proportion continues to decline year on year as the consumer side of the industry (Personal Services in particular), becomes more significant. In this year's survey only around three in ten are focussed more on the business to business sector.

The vast majority (78%) of UK franchise systems are owned by an organisation based in the UK. Just over one in ten (12%) are subsidiaries of a parent company which owns the franchise and just 10% are Master Licensees of a foreign franchisor. Foreign franchisors operating in the UK sampled come from USA/ Canada and Germany.

Figure 20: Type of Franchise System

Excludes dairies

	% based on 3 year rolling averages							
	2007		2008		2009		2010	
Ultimate owner of the system	604	75%	626	75%	648	77%	700	78%
Subsidiary of parent company that owns the system	89	11%	100	12%	101	12%	107	12%
Master Licensee of another company that owns the system	113	14%	109	13%	93	11%	90	10%

Base: All franchisors

6.3 Churn in franchising

As noted previously, although still lower than in some years, the number of units experiencing change has increased this year and stands at 8.8% overall. Commercial failure, whilst still low as a proportion of businesses overall, has increased very slightly (3.1% from 2.6%), and this might be due to businesses ‘hanging on’ in 2009 hoping for a better 2010, but then still finding trading conditions tough.

Figure 21: Unit Changes Reported by Non-Dairy Franchisors (2010 figures)

	Changed Franchisee	Bought Back	Closed Down	TOTAL	% All Units
All Reasons:	2033	118	1086	3237	8.8%
Commercial Failure	700	60	375	1134	3.1%
Dispute	225	5	53	283	0.8%
Realising Investment	290	28	119	437	1.2%
Retirement	308	6	109	423	1.1%
Ill health/ Domestic	280	17	214	511	1.4%
Other reasons	230	2	217	449	1.2%

Franchisors continue to err on the side of optimism with regard to growth expectations. On average franchisors say they have plans for an additional 9 units, which would amount to an additional 8,000 units overall. However, given similarly high projections have been cited in previous years and not matched, what in reality these figures suggest is the potential for

growth that exists in the mind of the franchisor, rather than concrete plans for expansion. This would also explain why future optimism remains despite economic confidence declining.

In line with the optimism expressed by franchisors, or perhaps fuelling it, is the assertion by 28% of franchisees that they plan to increase the number of units they operate in the future, whilst only 5% plan to decrease. Where change is planned, however, it is in the medium to long term, with just 6% planning to make changes in the next 6 months.

We continue to see franchisees holding onto their assets, perhaps until they can be realised in more buoyant times. This year, the projected number of re-sales is very similar to 2009 at 1,693, with a decrease in the number of average units being re-sold per system being compensated by the higher number of systems recorded this year.

Figure 22: Predicted Level of Re-sales

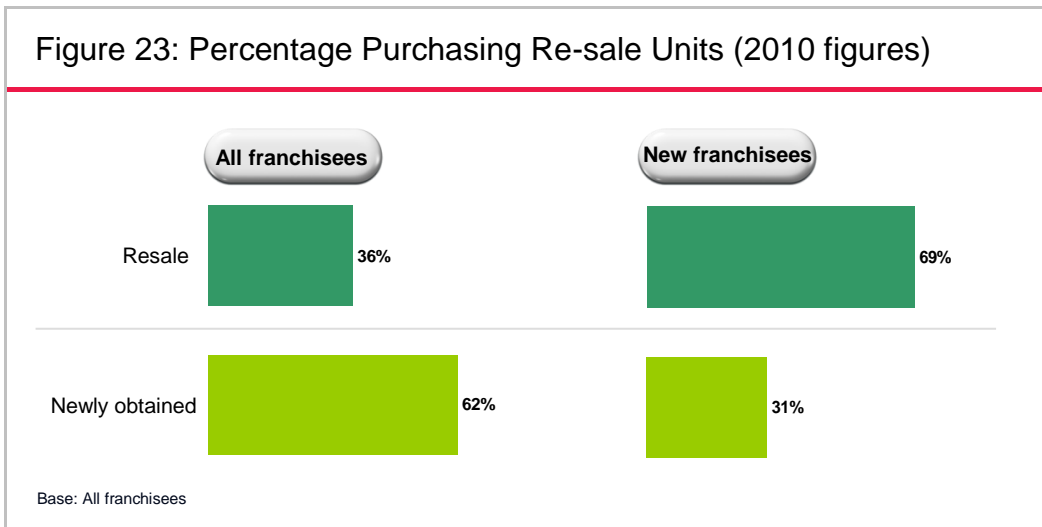
	Year of Forecast				
	2006	2007	2008	2009	2010
% Franchise Systems Expecting to Offer Re-sales	29%	52%	53%	49%	51%
Average No. of Re-sale Units Per System	4.5	3.3	5.65	4.07	3.7
Estimated Total No. of Re-sale Units Next Year	1,020	1,400	2,500	1,679	1,693

Base: All franchisors

Even so, re-sales are now the most common entry point for a new franchisee. A cycle is now established with units having been successfully set up and run for several, if not tens of years and passed on to new franchisees. It is a sign of a maturing industry. Indeed, a third of all franchisees are now running re-sale units. Some systems may have reached limits in their expansion (without excessive cannibalisation of existing territory) offering new franchisees no choice other than to opt for a resale.

In the chart below we can see that amongst new franchisees, (those in business for less than two years) seven in ten have taken over a pre-existing business.

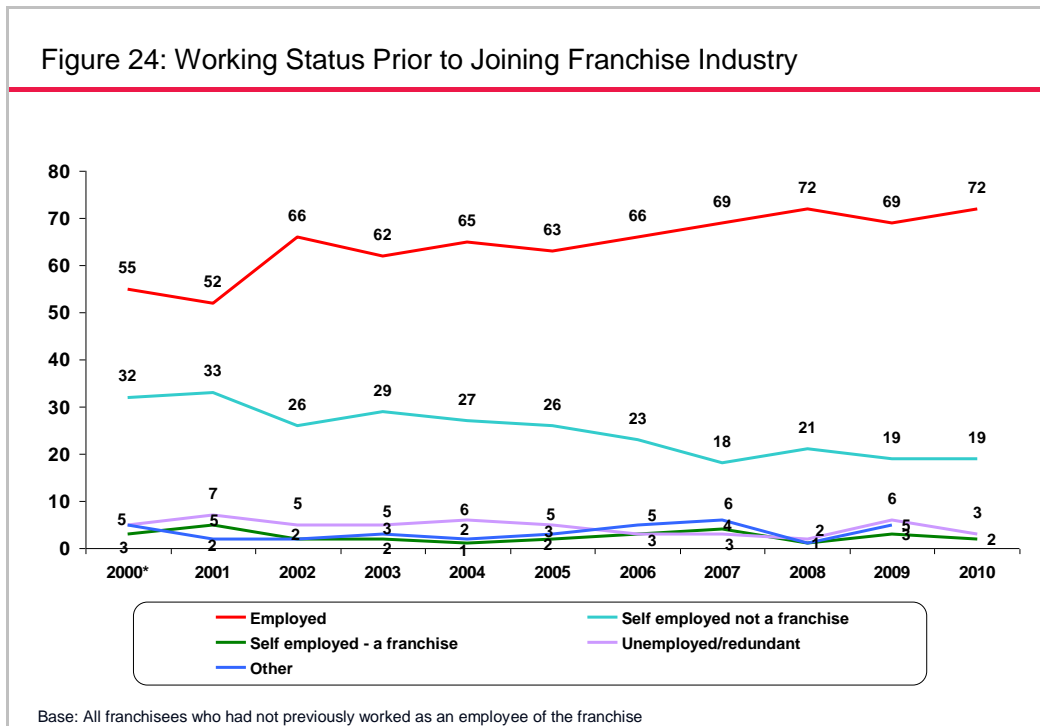
Figure 23: Percentage Purchasing Re-sale Units (2010 figures)



Exclusive territory is still the norm. Three quarters (78%) of franchisors offer exclusive territories to their franchisees, one in ten (13%) have a mixture of exclusive and non-exclusive, leaving only 8% only offering non-exclusive territories. Non exclusive territories are most common in the Business and Communications Services sector (25%) and have a general business to business bias (21%).

7. Building the franchising relationship

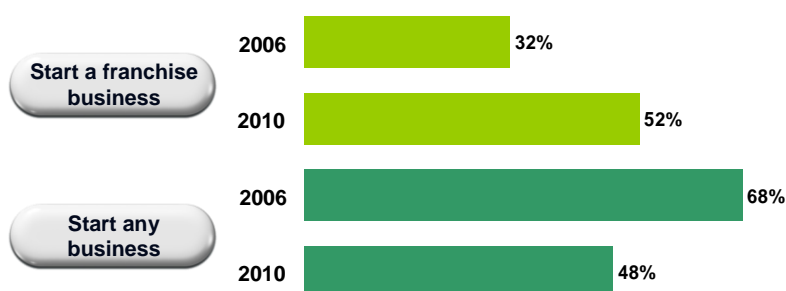
7.1 Where potential franchisees come from



Nearly one in five (18%) new franchisees come from inside the industry, either having worked directly for a franchisor or having been an employee of another franchisee. Of the remainder, the majority move to franchising from salaried employment. Over the last ten years, the proportion of franchisees who were previously self employed has drifted gradually down from around a third to around a fifth, although the latest data shows that 20% of the newer franchisees (under 2 years) come via this route, so there are no signs of any further drift.

In previous years, the authors have commented on the stated intentions of franchisees prior to entering the industry and used this to evidence a general lack of awareness of what franchising has to offer. At an overall level (all franchisees), the proportion saying that their initial intention was to start a franchised business has crept up over the years, but remains persistently below two in five. However, the difference in business start up intentions (shown below) between 2006 and 2010 amongst new franchisees does provide an extremely encouraging indicator of increased awareness over recent years.

Figure 25: New Franchisees' Business Start-up Intentions



Base: All new franchisees (2 years or less) who had not previously worked as an employee of the franchise, excluding don't knows

7.2 Sources of information for franchisees

When asking franchisees how they first heard about franchising, it immediately becomes apparent the extent to which word of mouth is key, both in terms of hearing about franchising in general, and about specific franchises. Friends and relatives are the most mentioned single source (24%) of initial awareness. This proportion is even higher for newer franchisees (30%).

Around one in five initially learns about franchising from trade magazines and a further one in ten hears about the industry either from visiting an exhibition or reading about franchising in a newspaper. In this digital age, even amongst newer franchisees, very few cite the internet / websites as the primary source of awareness.

However, the story is quite different when franchisees move on to the research phase. Here the internet is of far greater significance. Of those franchisees who have been in business for up to four years, over half (52%) visited their franchisor's website for information, just under one in five (18%) visited the bfa website, and one in five (20%) visited other franchise related websites.

One in four of these more recent starters visited a franchise related exhibition prior to taking out their franchise, with the National Franchise Exhibition at the NEC in Birmingham by far the most mentioned amongst the franchisees we spoke with.

A third (31%) of those holding a franchise for 3 years or less obtained a copy of the bfa information pack before they took out their franchise.

The variety of sources used demonstrates the importance of a multi-channel strategy for franchisors, and underlines how crucial it is to have both an online presence for general fact finding as well as face to face contact or more substantial conversations.

7.3 Franchisee brand consideration

Grabbing the initial attention and interest of potential franchisees is crucial to an effective recruitment strategy. Three in five (61%) holding a franchise for 3 years or less, considered only 1 franchise brand before making their final decision. The vast majority (87%) considered 3 or fewer.

There is some surprising openness amongst franchisees when it comes to sector, with one in five saying that they considered brands in more than one sector. This indicates that, for a significant minority, franchising itself is the allure rather than any particular type of business.

A proven track record in the shape of seeing successful existing franchisees is the biggest single reason given by those new to franchising in making their decision. This has grown over time, and this year interest in the field of business has halved in significance, perhaps reflecting franchisees looking for a strong economic outcome rather than a vocation per se.

Again, as with the initial awareness of franchising, we see the importance of the personal touch in this industry, with high proportions citing a reason as 'liking the people' and 'recommendation from existing franchisee'.

Figure 26: Reasons for Selecting a Specific Franchise

		2009	2008	2007
Existing franchisees successful	21	17	11	6
Growth potential	15	14	28	23
Interest in field of business	15	30	18	12
Liked the people	14	2	3	5
Affordability	13	7	4	12
Low risk	9	5	19	4
Recommendation from existing franchisee	9	2	3	-
Well known brand	8	7	7	19
Used to be employee of franchisee	5	5	4	-
Specialist business knowledge of franchisee	5	4	7	6
Used to be employee of the franchisor	4	1	5	-
Location of the business	4	6	5	6
Available territory	4	-	-	-
Recommendation from friends/ family	4	1	8	-
Used to be employee of similar franchise	3	1	1	-
Family support	1	7	2	1

Base: All franchisees who have held current franchise for 3 years or less

Franchisees make careful decisions. Unsurprisingly given the personal and financial investment involved. On average franchisees said they had sought advice or made checks with 6 different sources prior to signing their franchise agreement.

Judgements relating to the franchisor offer and the impact of running the franchise on their lives are the most frequently made assessments. In terms of external consultations, contact with existing franchisees is crucial in terms of assessing profitability and their opinion of the franchisor. Legal advice is sought by less than half, while accountants are more frequently consulted. Half checked that their franchisor was a bfa member, underlining the significance of bfa membership.

Figure 27: Checks Made & Advice Sought Prior to Signing a Franchise Agreement

	2009	2008	2007
Assess whether the franchise fees were fair + value for money	74	74	77
Assess the impact of running the business on your family	72	63	71
Ask existing franchisees whether their business was profitable	70	79	80
Seek advice from an accountant	67	71	83
Ask existing franchisees for their opinion of the franchisor	62	68	74
Check the financial stability	61	68	72
Seek advice from your main bank	60	60	67
Check that your franchisor is a bfa member	50	50	56
Seek advice on legal agreement from non-BFA affiliated franchise solicitor	39	51	56
Seek advice from another bank/ building society	36	39	46
Seek advice on the legal agreement from a bfa affiliated solicitor	20	33	34
Ask the franchisor whether they had operated a pilot	18	33	34
Used a franchise broker or consulting network such as Matchpoint	2	-	-

Base: All franchisees who have held current franchise for 3 years or less

7.4 Extent recruitment an issue for Franchisors

Recruitment remains a key issue for franchisors. Enticing strong recruits to the franchise industry is always a challenge, with competition from employers and from the allure of self starting a business. It had been anticipated with the recession that a ready supply of new and suitable recruits would become available with redundancy money ready to invest. However, we find this hypotheses partially refuted, as the lack of suitable franchisees stubbornly remains the most cited barrier to growth by franchisors (61%).

Despite industry sources confirming banks' favourable lending policies towards franchises compared to other business models, we continue to see a relatively high proportion of franchisors saying that a lack of finance and capital is holding their businesses back (56%) and a large increase for 'loan guarantee schemes not applicable'.

Overall, there do seem to be more barriers to growth (whether real or perceptual) this year than in previous years. This said, as the industry matures one might anticipate that it becomes harder and harder to maintain growth year on year, let alone during a period of economic instability.

Figure 28: Barriers to growth in UK Franchised Units

Prompted list		2009	2008	2007
Lack of suitable franchisees	61	51	36	65
Lack of finance/ capital	56	53	53	26
Poor economic conditions generally	50	44	56	32
Wish to expand steadily/slowly	29	33	7	44
Loan guarantee schemes not applicable	24	13	6	13
Competition from other franchises	20	11	15	21
Lack of suitable sites for franchisees	20	19	9	25
Static/ declining marketplace	19	12	7	15
Lack of available franchise areas	14	14	10	20
No desire to grow further	9	5	5	14
Red tape/ bureaucracy	8	14	7	13
Rent increases	5	6	-	-
Planning laws	4	11	5	8

Base: All franchisors

7.5 Methods of recruitment

Online is considered a key recruitment tool with 85% of franchisors considering their own website as particularly useful when recruiting new franchisees. This ties in with the franchisees own experiences of interrogating websites when making a decision. Franchisors are also harnessing the power of social networking with a fifth (22%) finding these sites useful.

Franchisors were asked which websites that they had used to recruit new franchisees in the last 12 months.

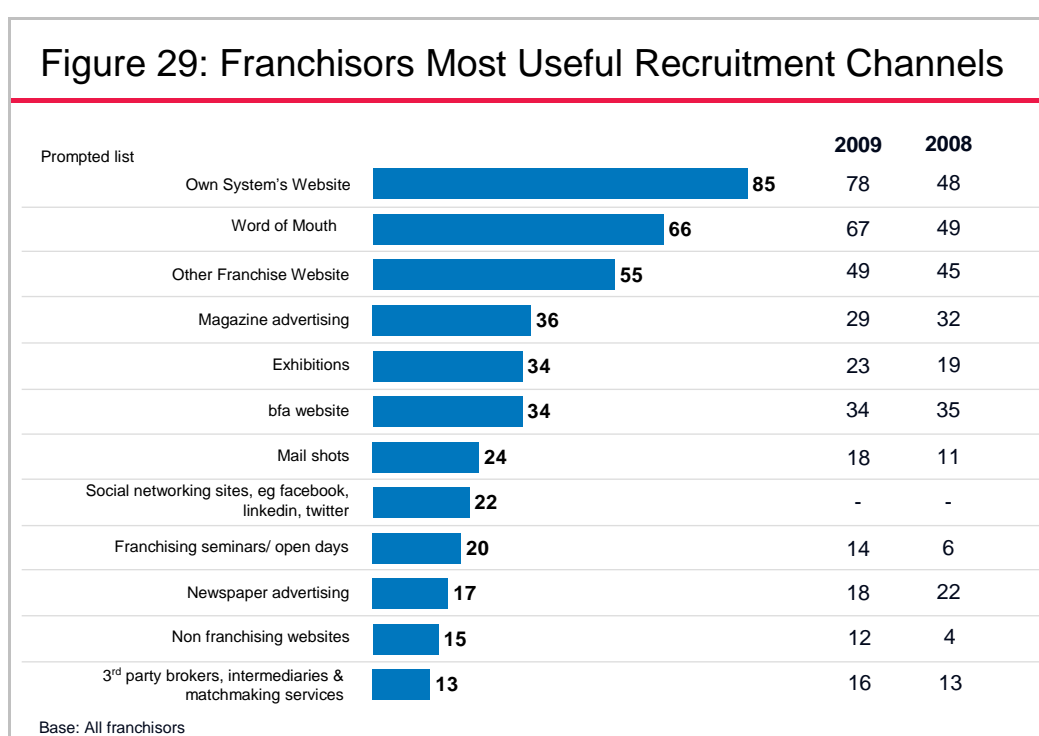
Thebfa.org	38%	(58% amongst its members)
Whichfranchise.com	35%	
Franchisedirect.co.uk	32%	
Franchisesales.com	24%	
Theukfranchisedirectory.net	23%	
Franchiseinfo.co.uk/ franinfo.co.uk	21%	
Selectyourfranchise.com	20%	
Totalfranchise.co.uk	19%	
Franchisesforsale.com	18%	
Thefranchisemagazine.net	17%	
Thisisfranchiseexpo.co.uk	12%	

All mentioned by more than 10%

Amongst bfa members, two in three stated that they received leads from the bfa website, with one in three obtaining in excess of 10 leads.

Online, although the most commonly used method, is by no means the only communications tool relied on. Significant proportions of franchisors mention above the line channels such as magazine advertising, exhibitions and mailshots . All of which, as well as other marketing, advertising and word of mouth, are useful in generating traffic to websites.

Franchisors recognise the importance of word of mouth, and see their franchisees (90% attribute word of mouth to franchisees) and colleagues (63%) as being central to this.



7.6 Lead generation and the sign up process

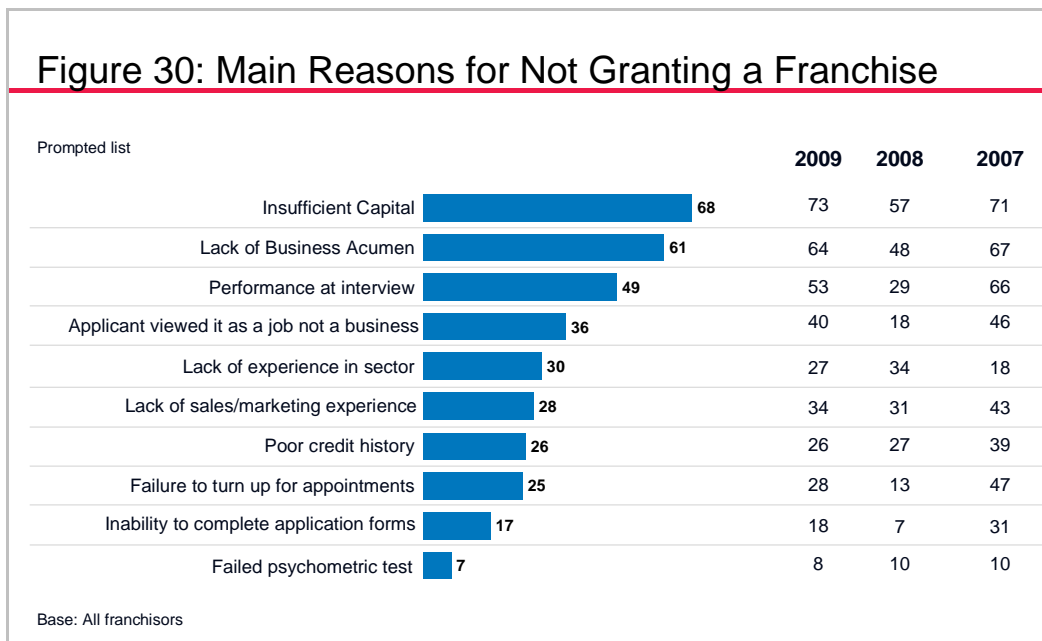
Franchisors spend approximately £2,000 on average on external costs such as advertising vacancies when recruiting franchises in the last 12 months, although a substantial proportion (40%) spent less than £1,000 (including 15% who spent nothing). But relatively speaking, this represents only a part of the overall franchisor resources expended in recruitment. Time is a highly significant factor, with man hours spent reading applications and interviewing candidates.

This year, the average number of leads and enquiries received by franchisors from all sources about their franchise was almost 700 (up from just over 500 last year). However, this figure

masks huge variation between systems and is not unexpectedly closely related to existing system size.

Clearly, a large proportion of leads and enquiries do not get past initial screening stages. On average, 40 result in interviews with potential franchisees, with an average of 9 candidates interviewed for every franchisee signed up. Larger systems (21+ units) interview almost 3 times as many people for each one signed (14 vs. 5, for those with under 20 units).

Potential franchisees are rejected primarily because of insufficient capital investment (68%) and a lack of business acumen (61%). This is consistent with last year, perhaps indicating that labour market conditions are broadly similar. A poor performance at interview, perhaps reflecting a lack of enthusiasm or a poor attitude is also another key factor (49%), which are critical for franchisors requiring someone who has drive and determination to succeed on their own; with support and assistance, rather than supervision.



Sign up times are stable over time. It takes on average 3-4 months from first contact for a new franchisee to sign a franchise agreement. It typically then takes a further 2 months before trading commences.

There is little variation by sector, average start up times (from lead to start of trading) are as follows:

	2008	2009	2010
Hotel & Catering	5.9 months	6.9 months	5.8 months
Store Retailing	6.2 months	6.3 months	7.1 months
Personal Services	6.2 months	5.2 months	5.7 months
Business & Communications Services	6.2 months	4.8 months	5.3 months
Transport & Vehicle Services	4.1 months	4.8 months	5.3 months
Property Services	4.4 months	4.3 months	5.4 months

7.7 Levels of investment required to open a new franchised unit

Clearly a key element for the franchisee in taking on a new franchise is meeting the initial investment required, and in order to make this process more straightforward, many franchisors now offer 'turnkey' solutions. What this means in practice is that the franchisor creates a package which includes the franchise fee, training, stock and all of the other materials required for the franchisee to get started in business.

This year we found that three in five (58%) franchisors offer such a package to new franchisees, ranging from 68% for Hotel and Catering to 51% for Personal Services and Property Services. The average cost of a solution is £45,000. There is wide range all the way from £2,000 up to £280, 000, although around a third of turnkey solutions have an entry point of £20,000 or less (more likely to be part time / Personal Services franchises).

A turnkey solution may include:

Training	91%
Franchisors licence fee	89%
Purchase of equipment/ fittings	78%
Purchase of stock/ materials	74%
Working capital	24%
Other	39%

Those not offering turnkey solutions gave an average figure of £48,700 for initial franchisee outlay which is broken down into the different components in the figure below. Not all

franchises charge for all the different items, which is why the average figure does not sum to all the different elements in the chart below. Charging models vary considerably on business type and franchise model, and not all franchises charge a franchise fee, preferring to earn income via stock and distribution costs.

Figure 31: Start-up Charges Levied by non-turnkey Franchisors

	Incidence %	Mean Amount Paid %
Initial Charge		
Franchise Fee	91	14,600
Equipment	64	23,100
Stock	62	13,600
Training	64	3,725
Working capital*	47	9,000
Other Charges*	25	21,900

Base: Franchisors (excludes 'don't knows') / All making each charge. *Base 30 or below. Figures are rounded to nearest 100

Year on year comparisons indicate that costs for entry have not significantly increased despite rising inflation. Combining average turnkey costs with initial costs for those not offering such a solution provides a mean start up cost of £46,600; very similar to the average in 2009 (£46,700).

NB: It should be stressed, that these are the costs involved in taking on the franchise. The total cost of setting up a business (particularly where property is involved) may be very much higher. Overall start up costs are discussed below in section 5.9

Comparing the average by sector we see costs are highest in the Store Retailing sector:

Store Retailing	£98,300
Hotel & Catering	£71,800
Business & Communications Services	£40,700
Property Services	£38,800
Transport & Vehicle Services	£34,400
Personal Services	£21,900

Although mean totals are useful at indicating the general scale of the costs required for each type of sector, i.e., higher for Store Retailing and Hotel and Catering, they mask huge variation within and between sectors, and therefore initial costs are perhaps better illustrated through individual examples, as shown below:

Figure 32: Start-up Charges Levied by Franchisors

	Example Costs for Each Franchising Sector (from survey data)					
	Hotel & Catering	Store Retailing	Personal services	Property Services	Transport & vehicle services	Business & Comms. Services
Turnkey: Range	£10,000 to 280,000	£19,000 to £100,000	£3,000 to £180,000	£10,000 to £80,000	£8,000 to £120,000	£2,000 to £150,000
Turnkey: Typical charge	£60,000	£60,000	£16,000	£28,000	£14,000	£40,000
Non-Turnkey						
Franchise Fee	£15,000	£37,500	£3,000	£3,000	£17,500	£10,000
Equipment	£75,000	£100,000	£3,000	£1,000	£2,000	£3,000
Stock	-	£100,000	£2,000	-	£2,000	£3,000
Working Capital	-	-	-	-	£3,000	-
Training	£20,000	-	£4,000	£11,000	£500	£9,000
Other	-	-	-	£6,000	-	£3,000
Non Turnkey Typical Initial Charge	£110,000	£237,500	£12,000	£21,000	£25,000	£28,000

Base: Franchisors (excludes 'don't knows')
* Figures are rounded to nearest 100

7.8 Levels of investment required for a resale

A significant proportion of franchisees (over a third - 36%) purchase their franchise as a re-sale from an existing franchisee, and small proportions (2%) simply convert an existing independent business of the same sector.

Franchisors find it difficult to estimate start up costs for an incoming franchisee in the event of a re-sale. When provided, average estimates tend to be lower than for starting from scratch, but this should be balanced against what might be a substantial 'goodwill' fee (paid to the franchisee). Indeed, franchisees purchasing re-sale units report higher overall initial investment sums than those starting from scratch.

Goodwill charges are highly variable. Size of system appears to be at least part of the equation, with the bigger brands tending to command higher re-sale values. Probably the biggest single factor relates to the nature of the business. For example, a business to business franchise with a list of established clients in the area is able to command more than a similar sized franchised business which relies more heavily upon one off purchases.

7.9 Levels of investment needed by new Franchisees

On average franchisees indicate that, including working capital, savings, borrowing and other sources of finance, they invested a total of £81,900 when they started up their franchise. This figure is subject to annual variation, but is broadly consistent with the average of just under £70,000 for 2008. What it does indicate is that the initial fees levied by the franchisor (turnkey or otherwise) represent only just over half of the total sum required to set up in business.

Franchisees in the Hotel and Catering Sector and Store Retailing sectors have, on average, higher outlays (although there is considerable variation within these), and lowest for Transport and Vehicle Services.

We consistently find that two in five (39%) franchisees state that they did not need to borrow any money to fund their initial investment. This does suggest quite large sums of funding appearing from somewhere, and in next year's survey the authors aim to discover the sources of this. Of those that did borrow, the average sum borrowed was £66,500, with one in five borrowing in excess of £100,000 (with such investors considerably over represented in the Hotel and Catering sector).

Banks will invest up to 70% of the start-up costs to a prospective franchisee and are the most common source of lending (81%), with relatives/ family (16%) the other significant lenders (increased from last year – 9%).

Over half (54%) of franchisors assist franchisees in raising their initial investment. In most cases (86%), this assistance is in the form of arranging an introduction to the franchise section of their bank, however, 3% claim to supply investment and 11% say they can both arrange and supply in conjunction with their banks.

7.10 Recurring costs levied by franchisors

In addition to initial start up fees, franchisors levy a range of ongoing fees throughout the term of the agreement, either relating directly to a proportion of sales achieved through royalties, or to other regular charges for marketing and other services. The most common fee charged is for management services, levied by 71% of franchisors.

On average, recurring fees charged account for 11.1% of sales. This is a somewhat lower figure than reported last year, but is in line with the longer term average.

These ongoing fees demonstrate the attraction of the franchising model for the franchisor and the importance to them of fostering successful, profitable franchisees.

Figure 33: Recurring Franchise Fees

	Incidence			Proportion of sales , 2008*	Proportion of sales , 2009*	Proportion of sales , 2010*
	2008	2009	2010			
Recurring	%	%	%	%	%	%
Management Services Fee	70	73	71	8.2	11.2	8.4
Royalties	39	29	27	9.5	12.4	10.1
Contributing to Advertising	47	55	49	3.9	2.6	2.3
IT Support Fee	23	14	17	1.5	0.7	2.2
Average % Recurring Fee				11.6%	13.3%	11.1%

Base: Franchisors (excludes 'don't knows')
 * Proportions based on franchisors making this charge

It is fairly common for franchisors to supply their franchised units with stock and supplies, with three in five (61%) doing so. While almost half (46%) do not charge a mark up on these supplies, the average for those that do is around 13% making this another important revenue stream for some franchisors.

7.11 Costs involved in launching a franchise

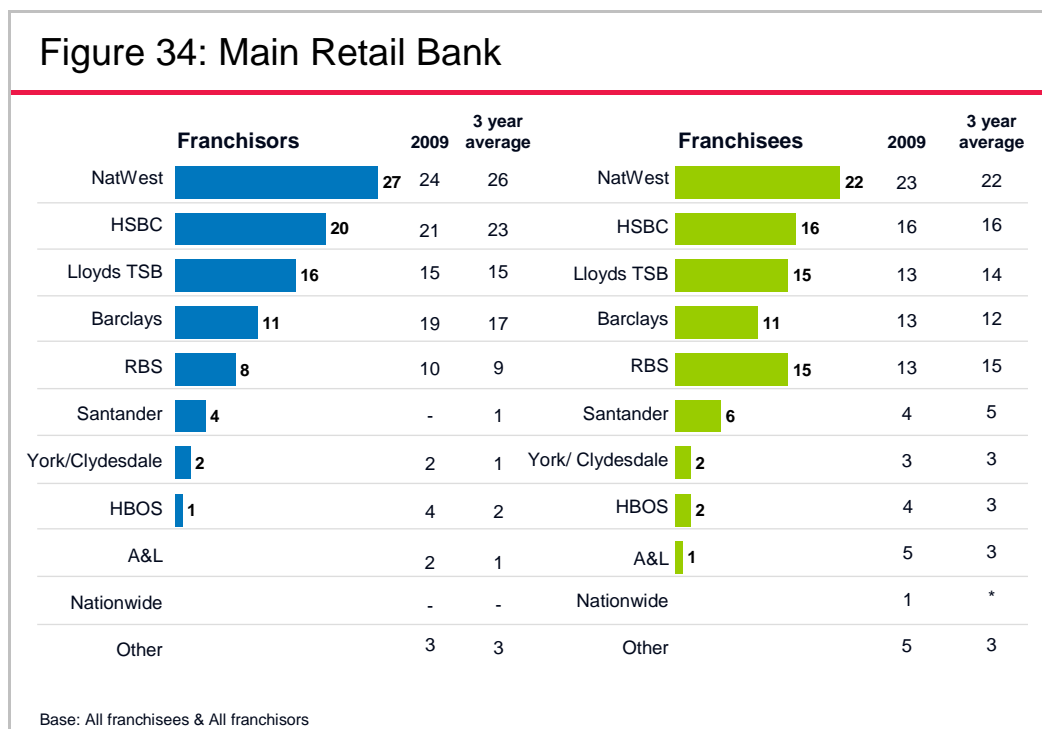
Whilst there are significant benefits to setting up a franchised business system, there are clearly costs involved in launching such an enterprise. More recent entrants to franchising (operating 4 years or less) were asked for estimates of the franchise start up costs. Given the relatively small numbers involved and the wide variations in set up costs between different business types (hotel versus cleaning van), and even within sector (take-away versus upmarket restaurant) it is not sensible to look at 'average' figures. Instead, here we provide examples of set up costs within each sector. Whilst we have chosen examples which are as representative as possible, these should not be thought of as 'typical' within each sector, but rather a guide to the potential scale of costs faced.

	Hotel & Catering	Store Retailing	Personal Services
Preparing legal agreement	£3,500	£8,000	£3,500
Consultancy advice	£6,500	£20,000	£5,000
Accountancy advice	£1,000		£3,000
Recruiting new employees	£1,000	£2,000	£1,000
Advertising	£1,000	£30,000	£6,000
Marketing at exhibitions	n/a	£10,000	£6,000
Market research	n/a	£10,000	£1,000
Setting up a pilot	n/a	£20,000	n/a
Investing in call centre capacity	n/a	£12,000	£3,000
Investing in IT	£6,500	£10,000	£3,000
Other costs	£750	£5,000	£2,000
Total launch costs	£20,250	£127,000	£33,500
Number of Franchised units	5	16	4

	Property Services	Transport & Vehicle Services	Business & Comms Services
Preparing a legal agreement	£7,000	£6,000	£6,000
Consultancy advice	£10,000	£40,000	£4,000
Accountancy advice	n/a	£1,000	£2,000
Recruiting new employees	n/a	£3,000	£4,000
Advertising	n/a	£8,000	£8,000
Marketing at exhibitions	£30,000	£8,000	£4,000
Market research	n/a	£1,000	£2,000
Setting up a pilot	n/a	£18,000	£2,000
Investing in IT	n/a	£10,000	£15,000
Other costs	n/a	£7,000	n/a
Total launch costs	£47,000	£10,200	£47,000
Number of Franchised units	1	11	11

7.12 Banking relationships

NatWest and Royal Bank of Scotland (RBSG) maintain their dominance within the franchising industry, with over a third of franchisors and franchisees using these brands as their 'main company's bank'. The biggest players dominate the market are NatWest followed by HSBC, Lloyds TSB, Barclays, and RBS.



8. Franchising community profile and relationships

8.1 Franchise characteristics

The age profile of franchisees has changed little over the last few years. The average age remains 47 years overall, and stands at 39 years amongst newer recruits to the industry, indicating that most have taken a different initial career path building experience, skills and perhaps the initial investment required. Currently only one in 20 franchisees is under the age of 30. One in five new recruits fall into this age bracket.

Whilst over the medium term there is stability with regard to the proportion of franchisees from ethnic communities, there are indications of this proportion rising moving forwards. This appears to be concentrated amongst Asians in general and more specifically those from Indian communities, with some indications of Middle Eastern communities getting involved.

Figure 35: Profile Characteristics of Franchisees

	All Franchisees		New Recruits - all held Franchise 2yrs or less	
	2005	2010	2005	2010
AGE:	%	%	%	%
Up to 30	10	5	17	21
31 – 40	20	20	27	34
41 – 50	32	36	35	25
Over 50	37	39	20	17
Typical (mean) age	46	47	41	39
STATUS:				
Married	81	81	78	71
Single	19	18	22	27
RESPONDENT GENDER:				
Male	80	74	84	75
Female	20	26	16	25
ETHNICITY				
White – British	82	84	79	73
White – other	3	2	-	3
Asian – Indian	7	5	10	11
Asian – other	1	3	3	3
Middle Eastern	0.4	1	1	3
Black – Any	-	*	-	*
QUALIFICATIONS				
None	32	14	23	11
Up to 'O' Level/GCSE	23	27	22	22
'A' Level	10	15	8	16
C&G/Trade	3	6	2	-
OND/HND/Dip	10	7	14	9
Degree	21	27	29	34
MBA	1	*	2	*

* Too small – less than 1%

The increase in the proportion of the general population with degrees is also reflected in the educational profile of franchisees. Now over a third of new entrants have a degree. However, franchising also remains a career opportunity for those with less formal educational backgrounds and one in ten new entrants have no qualifications.

The involvement of women in franchising has remained relatively constant over the past fifteen years at around a quarter of all franchisees. However, looking at the figures in more detail (below), it seems that the overall proportion of husband and wife teams is going down. Some of this is being accounted for by a greater proportion of men running franchises on their own. However, we also see a rise in the proportion of women running franchises alone to around 20%.

Figure 36: Ownership Profile of Franchisees

	All Franchisees				New Recruits All held Franchise 2yrs or less			
	2007 %	2008 %	2009 %	2010 %	2007 %	2008 %	2009 %	2010 %
Married team	29	26	22	21	28	27	30	17
Man solely	38	40	42	45	33	30	30	56
Woman solely	15	15	16	19	17	16	20	16
Male only business associates	6	9	10	8	7	9	9	3
Female only business associates	-	2	2	1	1	5	2	-
Mixed business associates	12	8	8	7	13	14	7	5
Men joint/sole owners	85	83	82	81	81	80	76	81
Women joint/sole owners	56	51	48	48	59	62	59	38

8.2 Categories of franchisee

Most franchisees run simple small businesses, with three quarters (78%) operating just one unit. However, some run more than one unit and the average for a multiple unit holding franchisee is just under 3 units. Multiple unit ownership is more prevalent in Hotel and Catering, where almost half of franchisees own more than one unit, compared to just 5% in business and communications services.

Figure 37: Franchise Unit Ownership by Unit Status

	All Units %	Sole trader %	Partnership %	Limited company %
Multiple Units	22	11	17	31
Single Unit	78	89	83	69

Base: All franchisees

Franchisees tend to be 'in it' for at least the medium term. The average length of time franchisees have held their business is 8.4 years. This is an increase from 7.5 reported for several years and perhaps again demonstrates the impact of the recession in generating reluctance to change. New entrants to the industry (less than 2 years) make up 15% of the total. There is little differentiation between sectors on these measures, indicating that there isn't any particular sector which suffers more highly from 'burnout'.

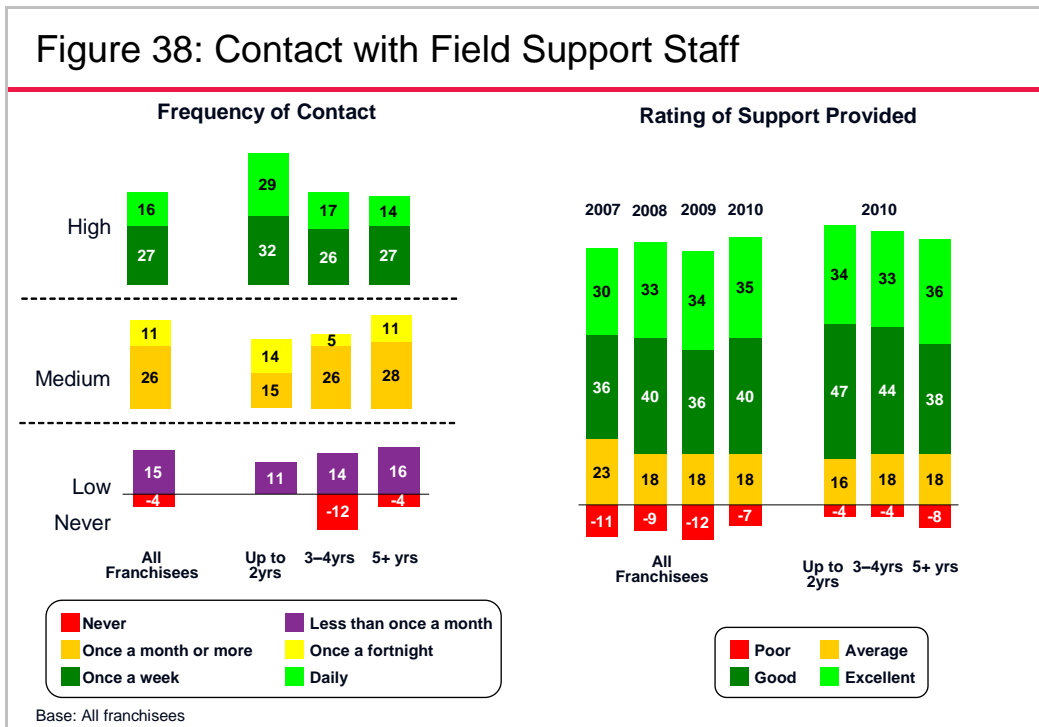
One third (34%) of franchisees run their businesses as sole traders, and 14% as partnerships. Just over half (51%) are now limited companies and these franchisees tend to have higher turnovers (£434,700 vs. £177,000 for sole traders).

8.3 Franchisee and franchisor relationships

As well as taking on a business model with a proven track record, franchisees benefit from continued support and guidance from their franchisor to develop their business, and this is a key selling point for many new franchisees. From the viewpoint of franchisors, frequent contact ensures that their franchisees are operating the system as they should be and are maximising opportunities for sales.

Many franchisors employ 'field support' staff, who act as a liaison between the franchisee and the franchisor in the areas of stocks and supplies, marketing and communications and system compliance. For the franchisee, field staff often represent the 'face' of the franchisor. Four in five franchisees report contact with their field staff within the last month. As might be expected, those new to franchising (less than 2 years) require the most frequent contact, with nearly twice as many reporting daily contact than those in the industry for 3 or more years. Store Retailing and Transport and Vehicle services are the most likely to have daily contact, probably due to logistical and stock requirements.

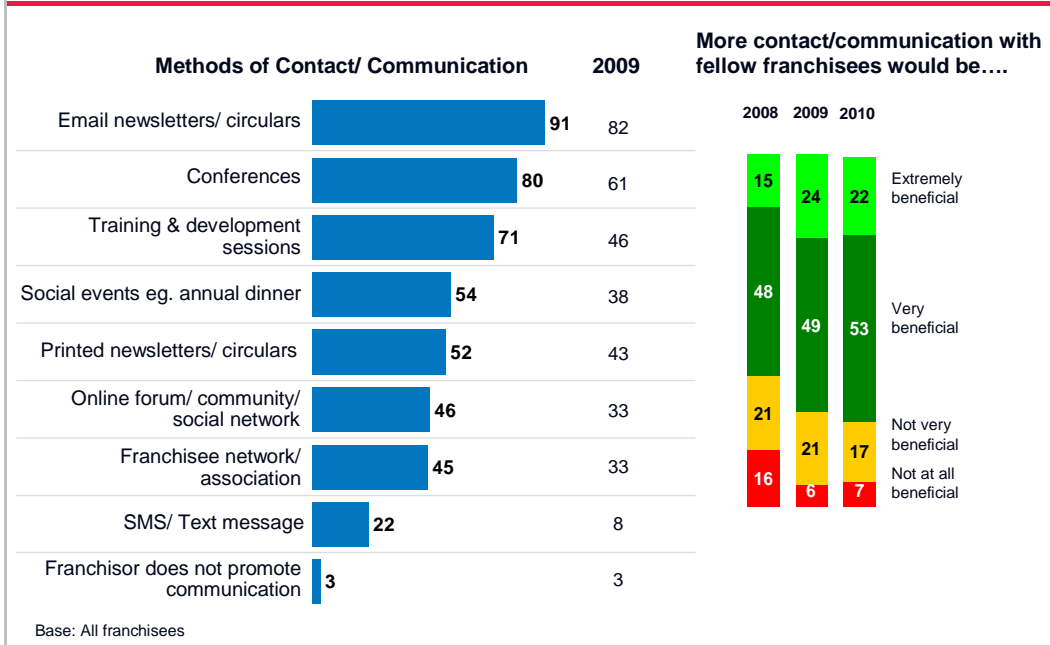
Figure 38: Contact with Field Support Staff



In recent years, the authors have spotted a strong correlation between franchisee profitability and frequency of contact. It is not possible to establish from the data whether this is a causal relationship i.e., that contact breeds success, or whether it is that more successful businesses seek more contact, or whether it is a mixture of both. What can be deduced is that frequent contact and strong relationships are likely to foster an environment for success.

Overall satisfaction levels with field staff support are higher than last year, with a small minority rating their field staff support 'poor' (7%) compared with over a third saying it is 'excellent'. Hotel and Catering are the most delighted, with 49% rating this support as 'excellent'.

Figure 39: Franchisor Promoting Communication between Franchisees



As a cheap, fast and highly responsive form of communication, it is not surprising that electronic forms of contact are the key plank of many franchisors communications strategies. 91% of franchisors using email newsletters/ circulars to promote contact/ communication between the franchises within the franchise brand. This said, around half still use printed alternatives.

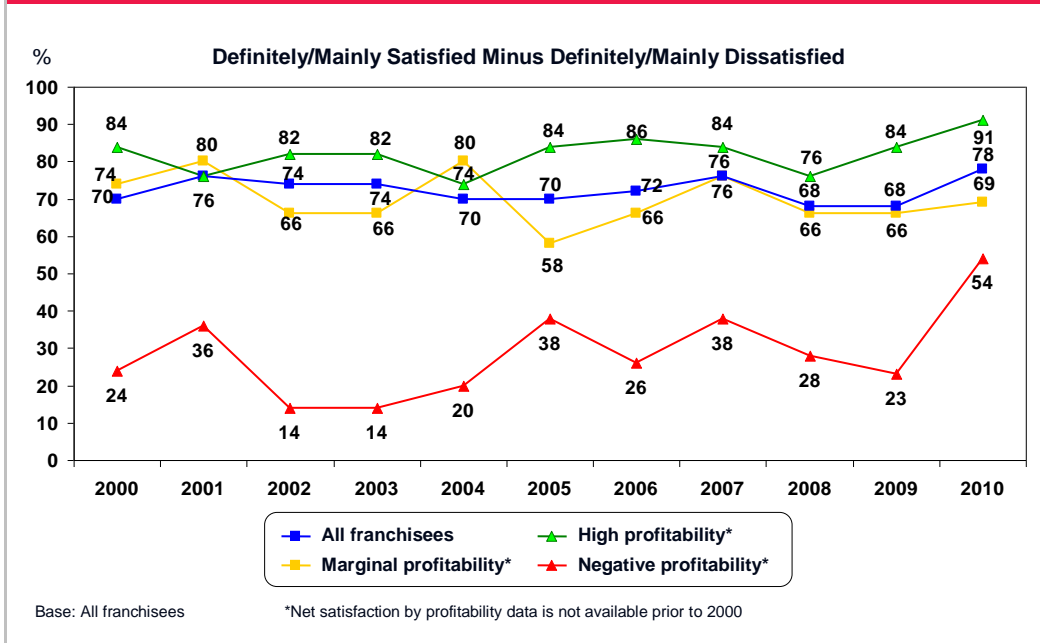
The opportunity to develop more personal relationships and convey key messages to franchisees through face to face contact in the form of conferences (80%) continues to increase by leaps and bounds, as well as high reported usage of training and development sessions (71%). All forms of contact see increases this year, indicating that franchisors are increasingly seeing the benefits of multi-channel communications in their business support strategy.

8.4 Franchisee satisfaction levels

Given that continuing economic difficulties provide plenty of potential for placing the franchisor/ franchisee relationship under strain, it is reassuring to note that compared with last year relations appear to have strengthened, partially reversing a previous decline.

Levels of satisfaction amongst franchisees with their relationship with franchisors are relatively high and consistent over time (89%), and over half find the relationship ‘definitely satisfactory’. Just as satisfaction with field staff correlates with franchisee profitability, satisfaction with the franchisor as whole is also strongly correlated.

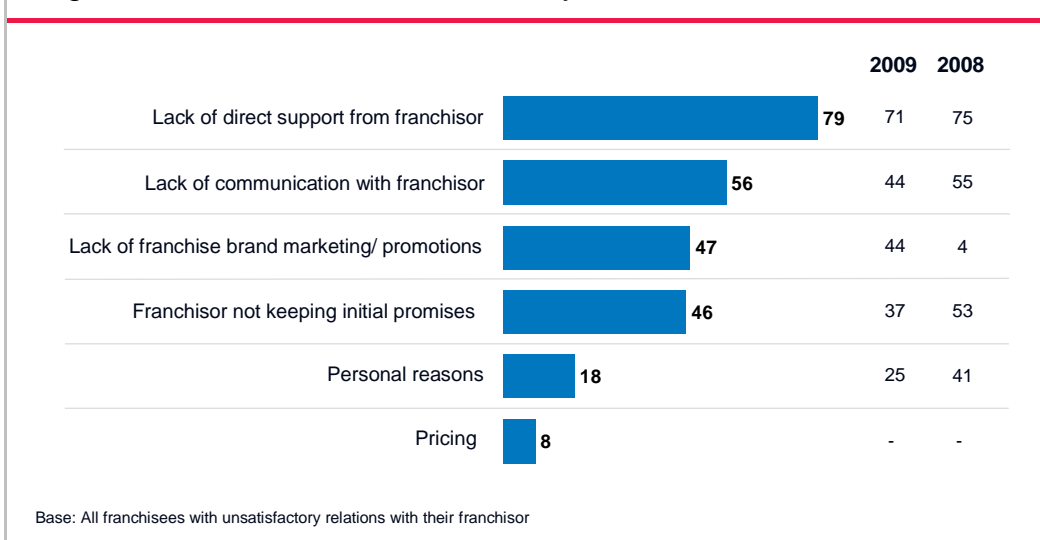
Figure 40: Net Satisfaction with Franchisor Relationships



A minority, (one in ten) find the relationship not satisfactory, with Business and Communications franchisees the most dissatisfied (21%), as last year.

Those franchisees unhappy with the relationship are asked to state the reasons for this. As in previous years, lack of support and lack of communication head the list.

Figure 41: Reasons for Unsatisfactory Relations with Franchisors



As with any business relationship, it's extremely important for realistic expectations to be set at the outset by the franchisor and understood by the franchisee. Currently, four in five franchisees feel that running a franchise has lived up to their expectations. A few it is too early to say, or simply don't know (4%), leaving the experience falling short for 15%. Again, a lack of direct support from the franchisor is the number one reason given for this.

Figure 42: Reasons for Not Having Expectations Met

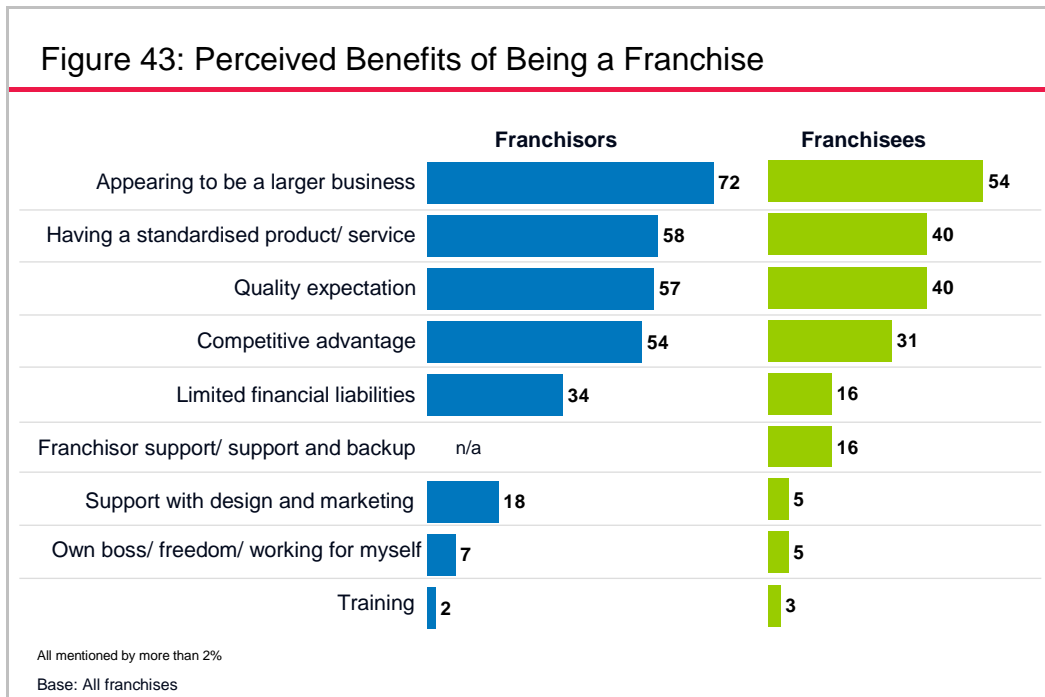
		2009	2008
Lack of direct support from franchisor	57	45	52
Lack of franchise brand marketing promotions	34	22	22
Franchisor profit projections misleading	33	29	28
Franchisee fee is too high	27	32	29
Franchisor not keeping initial promises	26	36	36
Franchisor misled me	24	30	34
Franchise is making a loss	21	26	23
Terms of Franchise too restrictive	19	24	17
Too much interference from franchisor	6	7	5
New management takeover detrimental to franchise	5	-	-

Base: All where franchise has not lived up to expectations (n=52)

8.5 Franchise status

For a majority of franchisees, running a franchise is perceived as a competitive advantage. Three in five say that they promote themselves as a franchise either to suppliers or to customers. Property Services and Transport and Vehicle services are the most likely to do this (72% and 75% respectively). Nine in ten franchisors claim to be open about their franchise status to end customers.

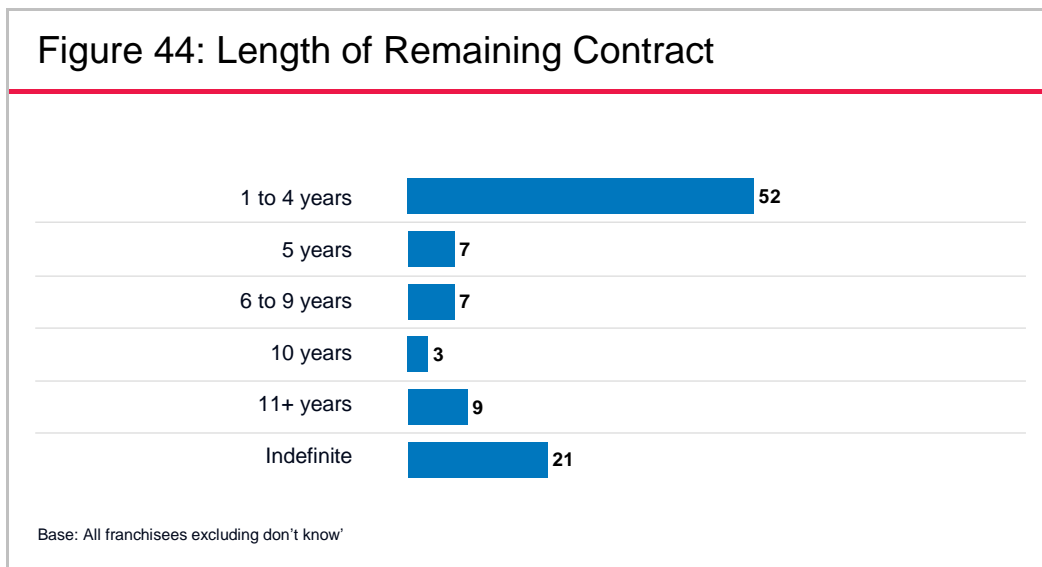
Franchisees and franchisors alike feel that giving the appearance of being a bigger business is the biggest benefit of being part of a franchise.



8.6 Contracts and renewals

Contracts between the franchisor and franchisee tend to be for a fixed period of time (around 5 years in most instances) with opportunities to renew at the end of the contract if this is felt to be desirable by both parties.

Three in four franchisors do not charge a fee for the renewal of the contract despite this being within their discretion. Rather than an opportunity to make money a fixed contract appears to offer both parties the opportunity to review their progress and to 'opt out' if required. Indeed of those that do make a charge, half levy a fee of less than £1,000.



The franchisee franchisor relationship can come to an end under a variety of scenarios: The franchisee may decide not to renew at the end of a contract, the franchisor might decide not to renew at the end of a contract, or, in the worst of cases, the contract may be terminated before expiry.

Half of existing franchisees have only 1-4 years left on their contract, but 71% of these intend to renew. The remainder are split evenly between 'don't know's' and those intending to give up their franchise. Amongst the latter, retirement will account for around a half of these, and the remainder (which only account for around one third of percent of franchisees) provide a multitude of reasons for quitting which include poor profitability as well as dissatisfaction with their franchisor.

Franchisors report an average of 2 contracts coming up for renewal in the last 12 months (similar to 2009), which corresponds to 2,036 franchise units in total. Most of these contracts

were renewed (1,900). Of those allowed to expire (an estimated 136 units) 97 did so as a result of decisions made by the franchisee and only 39 were terminated by the franchisor.

There were an estimated 933 terminations of contract in 2010 and three in five (62%) of these were initiated by the franchisor. Therefore forced termination equates only to around 1.5% of all units. The main reasons for a franchisor to terminate a contract are a combination of non-payment of fees and a failure to adhere to the format. From the franchisor perspective, where a franchisee does not follow the system format this can endanger the overall reputation of the franchise.

Figure 45: Franchise Unit Withdrawals & Terminations

	Non-Renewals (units)	Terminations (units)
By Franchisor	39	574
By Franchisee	97	359
Total	136	933

Base: All franchisees & All franchisors

8.7 Thinking of the future

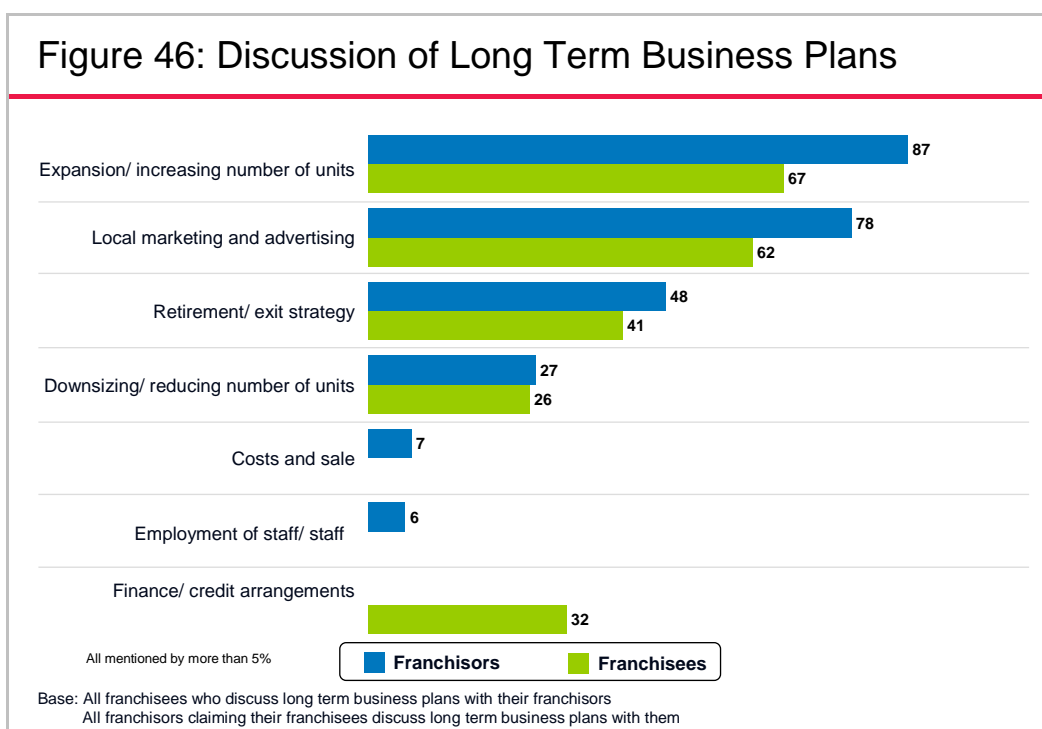
Just under half (47%) of franchisees are able to predict when they plan to exit franchising, leaving the rest uncertain of their future plans. Certainly, a good proportion of franchisees feel set for at least the medium term, with one in five (19%) planning to stay in the industry for 10 or more years (corresponding to two in five of those able to give a definite answer).

Discussion of long term plans with franchisors is slightly more prevalent than last year, with two in five (42%) franchisees claiming that they do so (32% 2009). This may be an indication that continuing economic uncertainty has to some extent 'forced the issue' as a topic for discussion. Certainly such discussions are likely to be helpful to both parties, and it is interesting to note that this year it is the most and least profitable businesses that are likely to be having such discussions.

There is however a perception gap between franchisors and franchisees about the extent they discuss 'long term plans'. Most (90%) franchisors claim they have spoken with their

franchisees on the subject compared to less than half (42%) of franchisees. Given the extent of this difference in opinion, it is likely that what is understood to be 'long term plans' differs between the two parties. For franchisees long term plans may involve details on their exit strategy, whilst for franchisors it may be more around future expansions and marketing. This divergence of thinking is illustrated in the chart below, with a higher proportion of franchisors citing conversations about local marketing and advertising as discussion of long term plans, than by franchisees.

Of course the types of plans discussed will depend hugely on the stage of the contract and the success of the business. It is perhaps premature to discuss the exit strategy one year into a 10 year contract, and long term plans in this context may be discussions of future expansion.



8.8 bfa membership

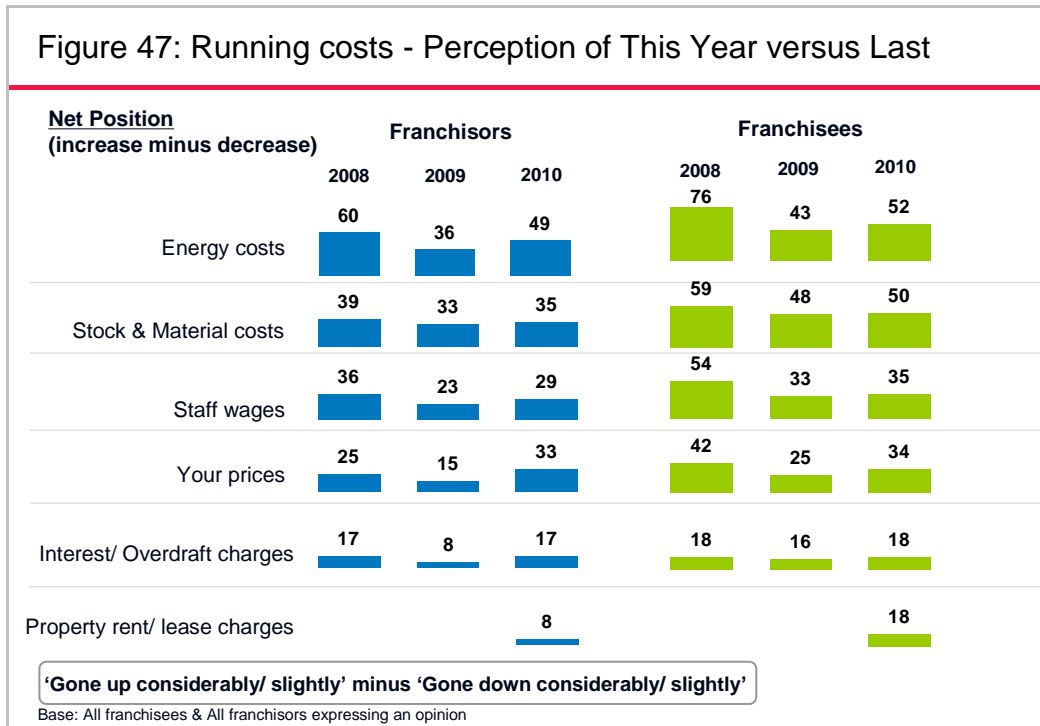
Well over a quarter of franchisors are members of the bfa (28%), with Full membership being the most common option (15%), followed by Associate (8%), and Provisional (6%). There is a progression, with provisional members looking to start their first/pilot franchise. To these nascent franchises, membership is relatively more expensive, but also hugely valuable as the process of accreditation carefully steers members towards the adoption of best practices within the industry. As these businesses grow and achieve higher levels of membership, so the status of bfa membership is attractive both to potential franchisees and those who fund them.

9. External pressures on franchising

9.1 Running costs

Inflationary pressures are running high in the economy due to global cost increases for raw materials, fuel and food. Businesses are facing increasing costs (perhaps with the exception of rental charges), and are sometimes faced with flat demand for their goods and services.

In order to track the impact of these macro trends on franchises we ask both franchisors and franchisees whether different cost elements in their businesses have increased, remained flat or have decreased. The chart below shows the 'net' response for each category (the difference between the proportion saying costs have gone down and the proportion saying costs have gone up)



Cost pressures eased for both franchisors and franchisees in 2009, but 2010 has seen these increasing again, particularly for energy. These increases have fed into a higher proportion of both groups saying their prices have risen this year – perhaps unable to find savings elsewhere to off set.

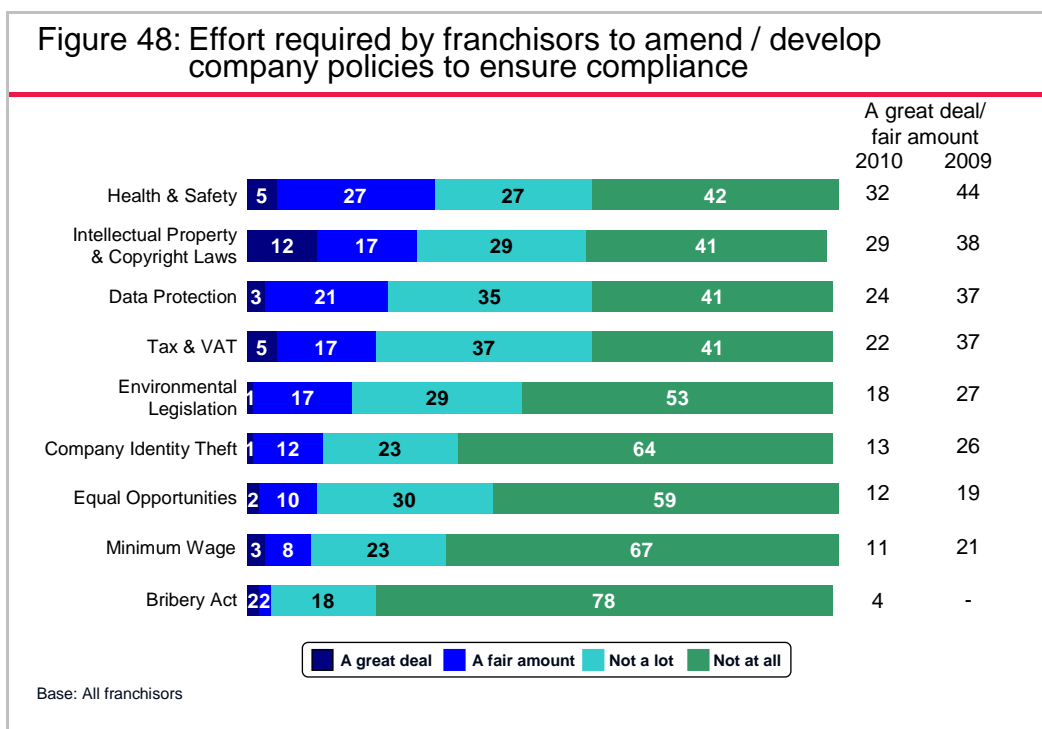
Hotel and Catering franchisees, with what is probably the broadest cost base in terms of energy, staffing and food, report the highest net figures for price increases, with Property Services and Transport and Vehicle Services the lowest.

9.2 Burden of compliance

Business in general and perhaps particularly SME businesses frequently complain that they are drowning under a sea of 'red tape'. Despite frequent government promises to reduce this burden, our research would indicate that compliance and regulation still take up a considerable amount of time for franchise businesses. That said, there would appear to be less time spent on such matters for both groups this year than last, perhaps indicating either a genuine reduction in red tape or at least the optimism that this will be delivered soon.

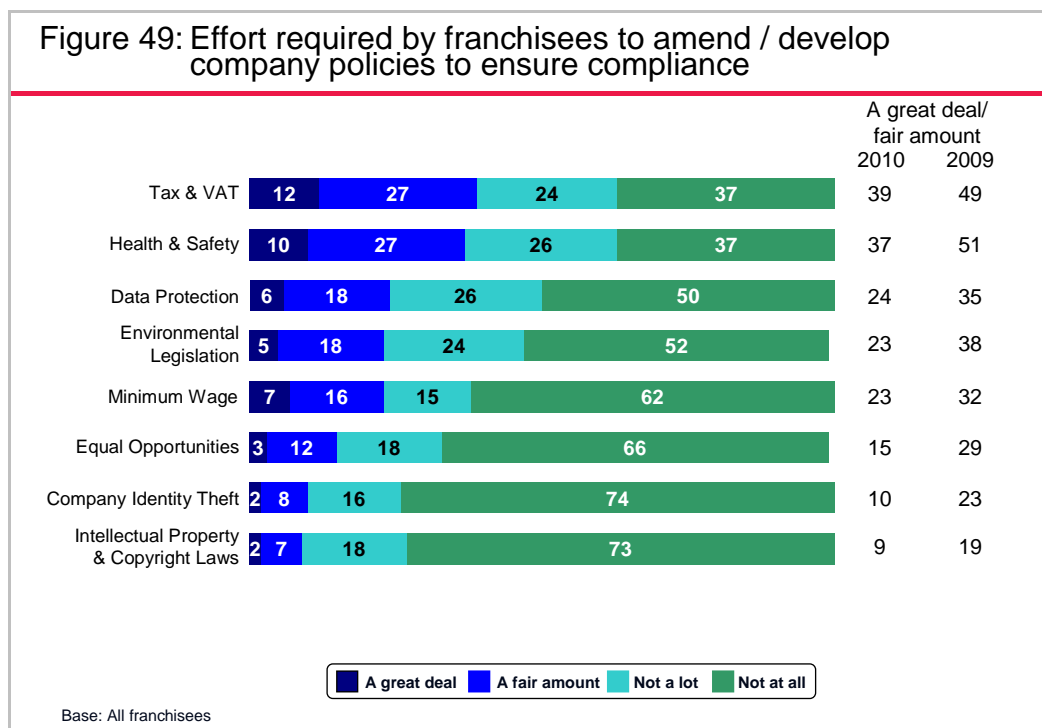
Both franchisors and franchisees were asked how much effort they have had to take in order to amend or develop company policies to ensure compliance with different types of regulations and legislation in the last 12 months.

Most time consuming for franchisors and franchisees alike are policies concerning health and safety with 32% of franchisors and 37% franchisees reporting that this takes a 'great deal/ fair amount' of effort. This is hardly surprising as health and safety legislation reaches all businesses and has extremely serious ramifications for non-compliance. This year, the survey asked franchisors about the bribery act for the first time, although it's apparent that this is a relatively low level concern for the industry.



There are several areas where a higher proportion of franchisees find compliance time consuming than franchisors, perhaps because they are more 'at the front line' dealing with customers and employees. Other than health and safety, these are environmental legalisation

(23% franchisees vs. 18% franchisors), minimum wage (23% vs. 11%), and Tax and VAT (39% vs. 22%). Conversely, intellectual property and copyright laws are clearly more of a consideration for franchisors, who have their own enterprise to protect (29% franchisors vs. 9% franchisees).



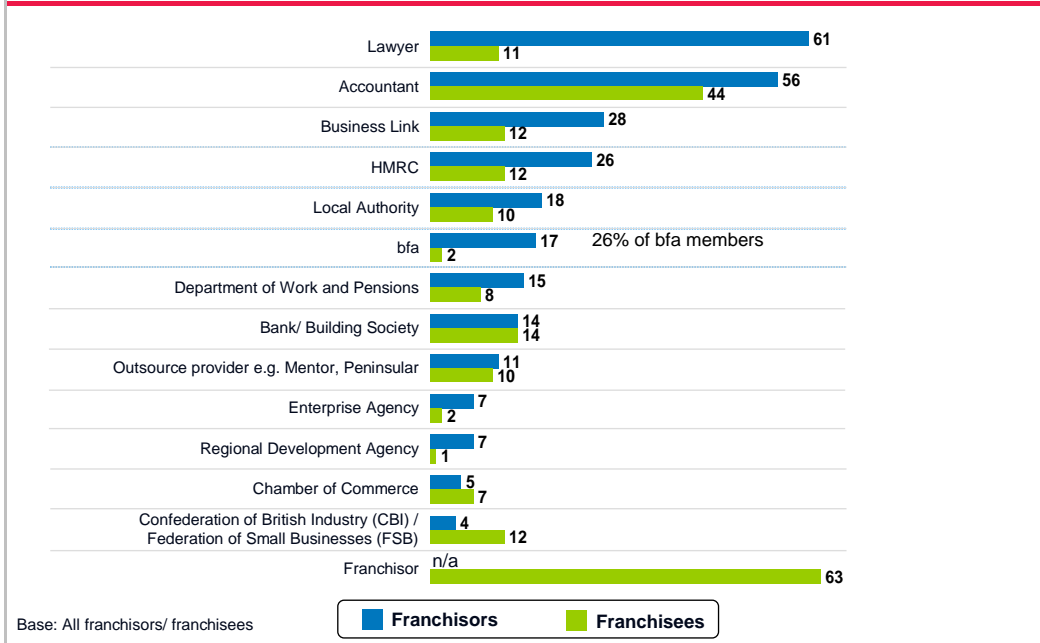
There is wide variation in the degree to which different sectors are affected by legislation. Hotels and Catering franchisees report amongst the highest burdens for health and safety (47% great deal/ fair amount), environmental legislation (48%), minimum wage (63%) and equal opportunities (29%). This is not surprising given the levels of staffing and staff turnover in this sector and the high level of contact with food.

9.3 Regulation and compliance information sources

If navigating ones way through regulation and legislation to ensure compliance is a challenge, then this challenge is at least partially met by consulting a wide range of information sources.

Lawyers are the first point of call for franchisors, although this is less of an option for franchisees, who rely on their franchisor to provide them the required information (in some cases perhaps getting legal advice second hand). On the whole franchisors use more sources of information, again indicating that franchisees tend to rely on their franchisor guiding them through this area. Accountants are well used by both groups and banks are consulted by similar proportions.

Figure 50: Sources of Information for Business Regulations & Legislation



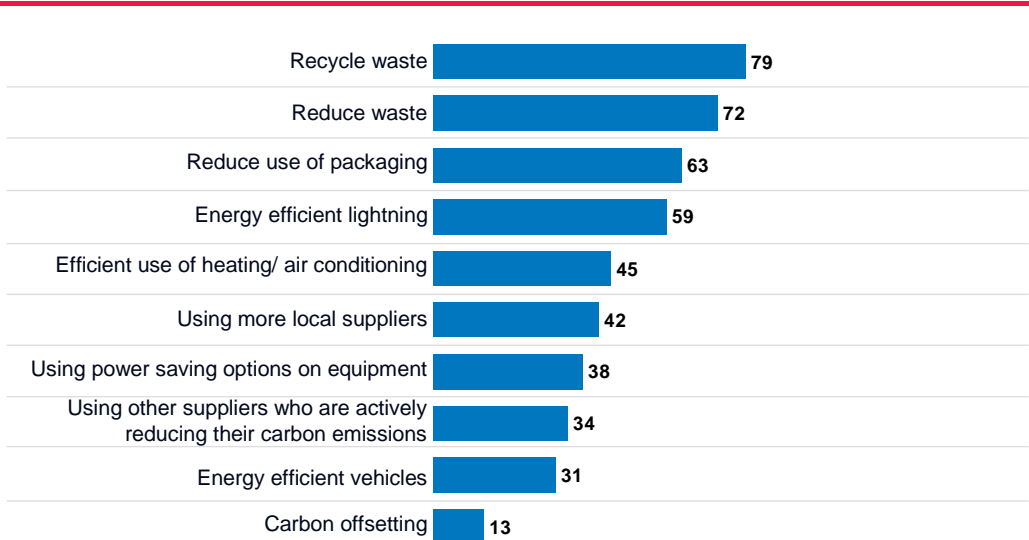
9.4 Going 'green' in franchising

Given the scale and scope of the franchising industry, measures taken to improve energy and waste efficiency do have an environmental impact. Franchisors are asked whether they have introduced any environmental measures aimed at reducing the impact of their operations. This year we see the proportion claiming to have taken action reduced from 41% to 33%. However, this may simply be that some systems have already had measures in place for several years.

Recycling and reducing waste are the main measures taken, as we can see in the figure below. Reductions in packaging, energy efficient lighting are also still on the agenda. Of course all of these measures are doubly beneficial in that they also save costs.

However, there are some more genuinely altruistic measures being adopted, such as using local suppliers, reducing carbon emissions and carbon offsetting.

Figure 51: Efforts to Reduce Environmental Impact



Base: All franchisors currently adopting environmental measures

Technical Appendix – Survey method

This is the 27th annual survey conducted on behalf of the British Franchise Association and sponsored by NatWest. Telephone interview surveys were conducted separately amongst franchisors and franchisees, between December 2010 and February 2011.

A. Franchisor Sample

A sample frame of active franchisors was derived from various sources. The principal reference point was the 2010 Franchise World Directory. This was supplemented by the list of bfa members, entries in the UK Franchise Directory and listings on www.franinfo.co.uk. This listing was reviewed and confirmed by leading industry experts at the bfa and the Franchise Section of NatWest.

Where a named individual in the franchising company was mentioned in any of these sources the interview was sought with them. Where no named individual was identified the interview was sought with the Franchise Development Director.

A total of 897 active franchisors were identified and included in the sampling frame for the interview part of the survey. Quotas were set according to the number of franchised units within a franchise with the aim of conducting forty five interviews with franchisors with 50 or more franchised units and a further five interviews with extremely large franchises (over 500 units). During analysis these groups were weighted to reflect their correct overall representation within the sample frame.

B. Franchisee Sample

From the list of systems created for the franchisor sample the various directories and databases were used, supplemented by expert information, to indicate how many franchised units (not company owned units) each franchisor has. In addition, figures supplied by franchisors in the survey last year were included where appropriate. Where the figure could not be determined a figure of three franchisees was assumed. The number of units was added to produce a total number of franchised units. For each franchise the number of units to be approached was determined by that franchise's share of the total number of units identified. Individual units were then traced using a national set of Yellow Pages directories, and interviews were sought with the owner/ partner. A screening question was included to identify any company owned units, which were then excluded from the sample.

C. Fieldwork & Analysis Details

For the two samples the data was collected by means of computer assisted telephone interviewing (CATI). The CATI fieldwork and analysis was carried out by Perspective, BDRC's telephone research facility. A total of 150 interviews were completed with franchisors. A total of 330 interviews were completed with franchisees by means of CATI. The main survey samples were then weighted to ensure overall representation of the six sectors of franchising activity and that franchise systems large (50 units+) and small were fairly represented.

D. European Franchise Federation (EFF) Classifications

The European Franchise Federation requires that its members are "all organically independent, registered and representative national Franchise associations or federations. The EFF categorise franchising into six broad sectors which are listed below. Each category contains a variety of distinct yet related franchising activities:-

- 1. Hotels & Catering:** hotels, bars & pubs, restaurants, fast food, mobile catering, industrial and commercial catering and 'other' hotel & catering.
- 2. Store Retailing:** hyper & supermarkets, convenience stores, general & department stores, clothes, shoes & accessories, electrical goods, kitchen & bathrooms, furniture & fires and 'other' store retailing
- 3. Personal Services:** hair & beauty, fitness and weight, care & education services, mobile & home distribution, computer & telephone services and 'other' personal services
- 4. Property Services:** estate agents & realtors, domestic & commercial cleaning services, property refurbishment & maintenance, gardens & landscaping, interior decoration & design, emergency & repair services and 'other' property services
- 5. Transport & Vehicle Services:** parcel & courier services, car & driver hire, vehicle repair & maintenance and 'other' transport & vehicle services
- 6. Business & Communication Services:** goods & consumables supply, equipment repair & maintenance, professional & financial services, IT & communications, employment & training services, print & design and 'other' business communication services

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