

Forms of Ownership and Franchising



Factors Affecting the Choice

- Tax considerations
- Liability exposure
- Start-up capital requirements
- Control
- Business goals
- Management succession plans
- Cost of formation



Major Forms of Ownership

- Sole Proprietorship
- Partnership
- Corporation
- S Corporation
- Limited Liability Company
- Joint Venture

Advantages of the Sole Proprietorship

- Simple to create
- Least costly form to begin
- Profit incentive
- Total decision making authority
- No special legal restrictions
- Easy to discontinue



Disadvantages of the Sole Proprietorship

- Unlimited personal liability
- Limited skills and capabilities
- Feeling of isolation
- Limited access to capital
- Lack of continuity



Advantages of the Partnership

- Easy to establish
- Complementary skills of partners
- Division of profits
- Larger pool of capital
- Ability to attract limited partners
- Little government regulation
- Flexibility
- Taxation



Disadvantages of the Partnership

- Unlimited liability of at least one partner
- Capital accumulation
- Difficulty in disposing of partnership interest
- Lack of continuity
- Potential for personality and authority conflicts

Types of Partners

■ General partners

- ◆ Take an active role in managing a business.
- ◆ Have unlimited liability for the partnership's debts.

■ Limited partners

- ◆ Cannot participate in the day-to-day management of a company.
- ◆ Have limited liability for the partnership's debts.

Types of Corporations

- **Domestic** – a corporation doing business in the state in which it is incorporated.
- **Foreign** – a corporation doing business in a state other than the state in which it is incorporated.
- **Alien** – a corporation formed in another country but doing business in the United States.

Advantages of the Corporation

- Limited liability of stockholders
- Ability to attract capital
- Ability to continue indefinitely
- Transferable ownership



Disadvantages of the Corporation

- **Cost and time of incorporating**
- **“Double taxation”**
- **Potential for diminished managerial incentives**
- **Legal requirements and regulatory “red tape”**
- **Potential loss of control by founder(s)**

S Corporation

- No different from any other corporation from a legal perspective.
- For tax purposes, however, an S corporation is taxed like a partnership, passing all of its profits (or losses) through to individual shareholders.
- To elect “S” status, all shareholders must consent, and the corporation must file with the IRS within the first 75 days of its tax year.

Limited Liability Company (LLC)

- Resembles an S Corporation but is *not* subject to the same restrictions.
- Two documents required: the *articles of organization* and the *operating agreement*.
- An LLC cannot have more than *two* of these four corporate characteristics:
 - ◆ Limited liability
 - ◆ Continuity of life
 - ◆ Free transferability of interest
 - ◆ Centralized management

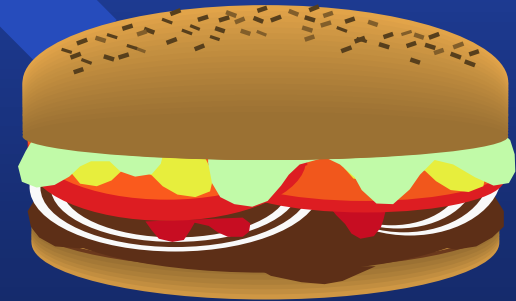
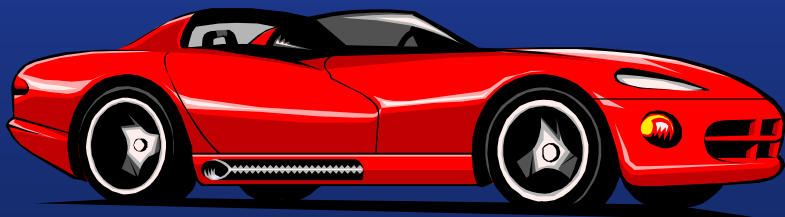
The Franchising Boom!!!

- Sales of \$1 trillion in virtually every product or service imaginable.
- More than 4,500 franchisers operating some 600,000 outlets worldwide.
- Franchise sales account for 44% of total retail sales.
- A new franchise opens somewhere in the world every six-and-a-half minutes.



Types of Franchising

- Tradename
- Product distribution
- Pure (or Comprehensive or Business Format)



Benefits of Franchising

- Management training and support
- Brand name appeal
- Standardized quality of goods and services
- National advertising program
- Financial assistance
- Proven products and business formats
- Centralized buying power
- Site selection and territorial protection
- Greater chance for success



Drawbacks of Franchising

- Franchise fees and profit sharing
- Strict adherence to standardized operations
- Restrictions on purchasing
- Limited product line
- Unsatisfactory training programs
- Market saturation
- Less freedom



Ten Myths of Franchising

1. Franchising is the safest way to go into business because franchises never fail.
2. I'll be able to open my franchise for less money than the franchiser estimates.
3. The bigger the franchise organization, the more successful I'll be.
4. I'll use 80 percent of the franchiser's business system, but I'll improve upon it by substituting my experience and know-how.

Ten Myths of Franchising

(continued)

- 5. All franchises are the same.**
- 6. I don't have to be a hands-on manager. I can be an absentee owner and still be very successful.**
- 7. Anyone can be a satisfied, successful franchise owner.**

Ten Myths of Franchising

(concluded)

8. Franchising is the cheapest way to get into business for yourself.
9. The franchiser will solve my business problems for me; after all, that's why I pay an ongoing royalty fee.
10. Once I open my franchise, I'll be able to run things the way *I* want to.

Detecting Dishonest Franchisers

- Claims that the contract is “standard; no need to read it.”
- Failure to provide a copy of the required disclosure documents.
- Marginally successful prototype or no prototype.
- Poorly prepared operations manual.
- Promises of future earnings with no documentation.
- High franchisee turnover or termination rate.
- Unusual amount of litigation by franchisees.



Detecting Dishonest Franchisers

(continued)

- Attempts to discourage your attorney from evaluating the contract before signing it.
- No written documentation.
- A high pressure sale.
- Claims to be exempt from federal disclosure laws.
- “Get rich quick” schemes, promising huge profits with minimal effort.
- Reluctance to provide a list of existing franchisees.
- Evasive, vague answers to your questions.

The Right Way to Buy a Franchise

- **Evaluate yourself – What do you like and dislike?**
- **Research your market.**
- **Consider your franchise options.**
- **Get a copy of the franchiser's Uniform Franchise Offering Circular (UFOC) and read it.**
- **Talk to existing franchisees.**
- **Ask the franchiser some tough questions.**
- **Make your choice.**

Factors That Make a Franchise Appealing

- Unique concept or marketing approach
- Profitability
- Registered trademark
- Business system that works
- Solid training program
- Affordability
- Positive relationship with franchisees

Trends Shaping Franchising

- Changing face of franchisees
- International opportunities
- Smaller, nontraditional locations
- Conversion franchising
- Multiple-unit franchising
- Master franchising
- Piggybacking (Combination franchising)
- Serving baby boomers

