

FRANCHISE SURVEY 2008



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Introduction & Background

This report reviews the 24th annual research study among franchisors and franchisees, conducted on behalf of the British Franchise Association and sponsored by NatWest.

This study has been updated with new survey research conducted between November 2007 and January 2008. These timings allow franchisees and franchisors to comment on their franchising activity for the 2007 calendar year. Where appropriate, this new information has been supplemented with information from other franchise industry expert and statistical sources.

The main survey uses computer aided telephone interviews (CATI) conducted with a stratified random sample of Franchise Development Directors/Managers at a system level and owners/partners of franchise units. As last year, franchisors were also able to complete the survey online, at their convenience.

The majority of the interview content remains constant from one year to the next, in order to update the core tracking data, and so set the scale and nature of the current business format franchise market in a historical context.

Whilst trends and events are analysed with this long-term perspective, the study also tackles new current issues. This year the interview incorporates highly topical questions on the social responsibilities of franchising (age discrimination and carbon footprints), the impact of immigration from Eastern European countries and the prevalence of business continuity arrangements.

In this report where reference is made to specific years this is the calendar year that respondents are asked to consider and comment on. Therefore this report, although published in March 2008, refers to information relevant to activities in 2007. Similarly, 2006 data was reported on in March 2007, and so on throughout.

Within BDRC, the principal author of this report is Paul Samuels, Associate Director, with additional input and overview from Dr Crispian Tarrant, Chief Executive BDRC Group.

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Note on Statistical Confidence

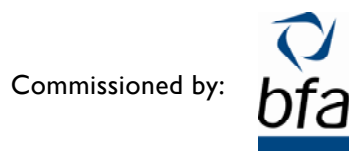
Much of this report is based upon the findings of survey research studies, to which statistical confidence limits apply.

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=345)	+/-3%	+/-5%	+/-6%

Note that the finite population correction applies to the franchisor sample. Since the sample is a substantial proportion (20%) of the population this enhances our statistical confidence in the survey findings.



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Management Summary

Over the last ten years the franchise industry has grown and matured into a significant element of the UK economy, contributing an estimated £12.4 billion to the country's GDP last year. Growth in average turnover per unit and productivity continue to outperform the economy as a whole.

Franchising has outstripped the UK economy for the second year running with an impressive growth of 15% over the national GDP of 3.1%. Government (Office of National Statistics) data indicates that economic growth is slowing but the strong performance of franchising is positive for the economy.

The number of active business format franchise systems identified in 2007 is 809. In contrast to earlier, erratic periods of growth the number of franchise systems is advancing at a steady rate of 3% on average over the last five years. To support this image of an established industry, churn rates (the number of system withdrawals) are at their lowest level since the turn of the century.

2007 was a year of expansion for many franchise systems. The number of franchise units increased by 8% taking the total to 34,200, the highest number since tracking began in 1984. In the face of a weakening economy (slower consumer spending, static house prices, etc), franchise systems are determined to continue opening new units with predictions suggesting that around 35,500 units will be trading by the end of 2008.

Franchising is a major employer in the UK, employing 1.3% of the working population, 383,000 people. Employment in the sector increased by 3% last year compared with 0.1% nationally. Recruitment remains the main barrier to expansion, a problem which is not likely to ease if unemployment remains at a historic low.

Europe remains the main target for overseas expansion. A third of UK franchise systems operate internationally, nearly all of whom have developed on the continent. Other markets include the US, Australia and New Zealand.

The proportion of units experiencing 'forced change' (commercial failure & disputes) remains historically low but has increased compared to last year. While it is clearly too early to say whether this indicates an upward trend it is a development that needs to be closely monitored. Franchise systems remain firmly optimistic that their own business will continue to perform well but confidence in the wider economy is at a record low.

Franchising is gradually moving away from the white, male dominated stereotype. Increasingly, franchising is attracting more women and people from ethnic communities. The British Indian community is particularly prominent among new applicants becoming franchisees.

Increasingly, franchise systems are heeding the environmental message and adopting measures to reduce their carbon footprint. It may reflect the pressures on profit margins but a third are actively pursuing policies designed to reduce carbon emissions the bulk of which aim to reduce energy usage and wastage.

I. The Scale of Activity

I.1 Franchise Industry Size & Dynamics

For the past 24 years the annual NatWest / bfa Franchise study has explored and tracked developments in the UK franchising sector. Over nearly a quarter of a century, franchising has grown from relatively humble origins into the mature and established sector of the economy that the study reports on this year.

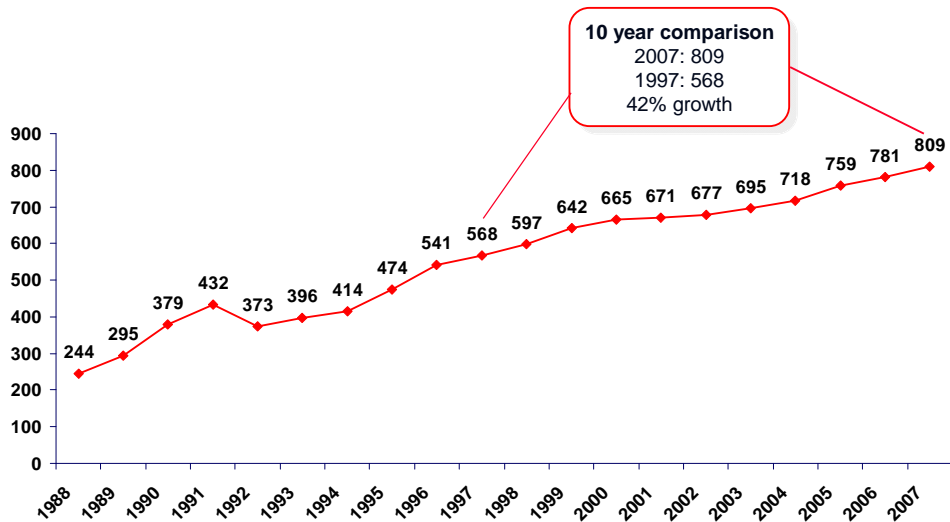
As the leading and longest running report on UK franchising, the Franchise Study analyses information and opinion from Franchise Development Directors (referred to as “franchisors” henceforth) and the owners of franchised units (“franchisees”) to construct a representative view of the industry. Due to the long-standing nature of this report, one, five, and ten year comparisons are drawn to show the growth in, and movement of key industry metrics over time.

In conducting the NatWest / bfa Franchise survey, the focus 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 (rather than company owned) unit. This excludes many businesses that may have announced plans to franchise, but do not currently operate any functioning units, as well as those that have withdrawn from franchising format but continue to trade through company owned outlets. This definition is applied when constructing the estimate of business format franchises operating in the UK and it should be noted that other sources may differ.

Various sources are used to gauge the number of franchise systems in operation, for which the authors are grateful. These include the Franchise World Directory, the UK Franchise Directory, www.franifo.co.uk and other lists of systems known to be operating in the UK. From these sources and the lists from previous studies, an initial ‘long list’ is compiled. This is then subject to intensive review by industry experts at the British Franchise Association and NatWest’s Franchise Section, until satisfied that only active systems are included.

The current report estimates that there are 809 franchised systems operating in the UK, an increase of 3.5% on 12 months ago. In real terms this represents a respectable net increase of 28 systems, demonstrating that franchising remains an attractive proposition for businesses. It should be noted that the total system estimate includes the three major dairies in the UK: Express, Dairy Crest-Unigate and ACC.

Figure 1: Number of UK Business Format Franchise Systems



With the notable exception of 2005, the number of franchised systems has grown at or near 3% over the past 5 years; a steady rate of growth supporting the profile of a maturing but still energetic sector of the economy. Growth has slowed compared to earlier periods (between 1995 and 2000 growth averaged 7%) but when placed in the context of the years 2000 to 2002, when system growth nearly plateaued, the picture is all the more encouraging.

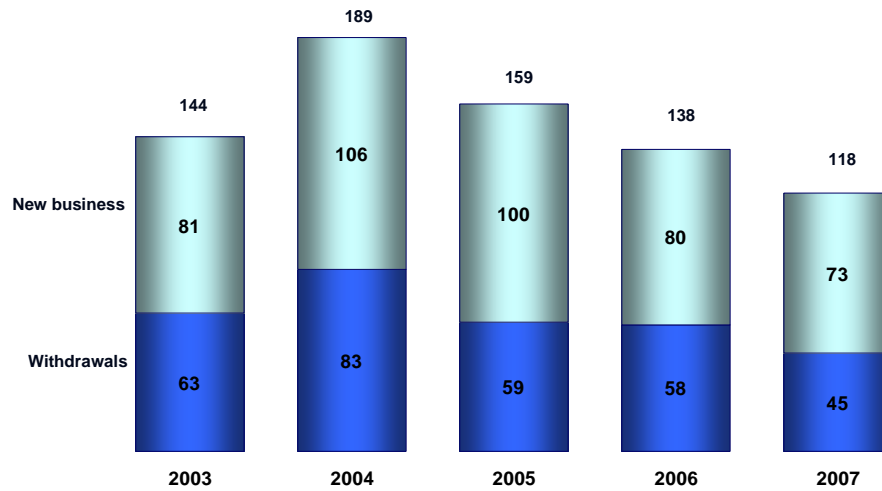
If this steady growth rate continues over the coming years, 2015 will see more than 1000 active franchise systems in operation in the UK. However, this may prove to be a big 'if' should wider economic growth continue to slow in the wake of the credit crunch, US slow-down, declining consumer spending and the cooling housing market. The economic outlook may be uncertain but the authors would point to similar circumstances at the outset of 2007 and the robust performance of the franchising sector last year.

While the aggregate number of franchise systems continues to grow steadily, the individual sectors that make up the whole are more subject to change. Recently franchise system growth has been powered by the property services sector (7% rise in system numbers) and hotels & catering (+6%). Store retailing systems remain unchanged and the business communication sector consolidated further this year (-1%), yet that the number of units rose by 5% and 7% respectively for these two sectors suggests that system level efficiencies may be boosting unit increases. Systems for transport and vehicle services and personal services grew by 4% each, while their number of units grew by an impressive 14% and 20% respectively.

The maturing nature of the franchising business model is further demonstrated by the year on year fall in churn rates (systems withdrawals) affecting the sector. System withdrawals are at their lowest levels for five years at 6% (down a percentage point on last year), while the accompanying new launch rate runs at 9%, so generating the net gain of 28 units. Although the launch rate outstrips churn, it too is falling year on year, a trend that may be accelerated if the tightening in the credit markets limits business expansion plans.

Many of the withdrawals and additions are not the result of commercial failure or new business start-ups. Much of the 'churn' in the industry is the result of companies deciding to discontinue franchising as a means of expansion, or companies new to franchising conducting trials to test its viability. The criteria we use for inclusion are also extremely strict, so each year some companies are no longer considered appropriate for inclusion (see Technical Appendix). Many brand names may therefore continue to trade successfully (with company-owned outlets), but are no longer judged to be actively involved in franchising.

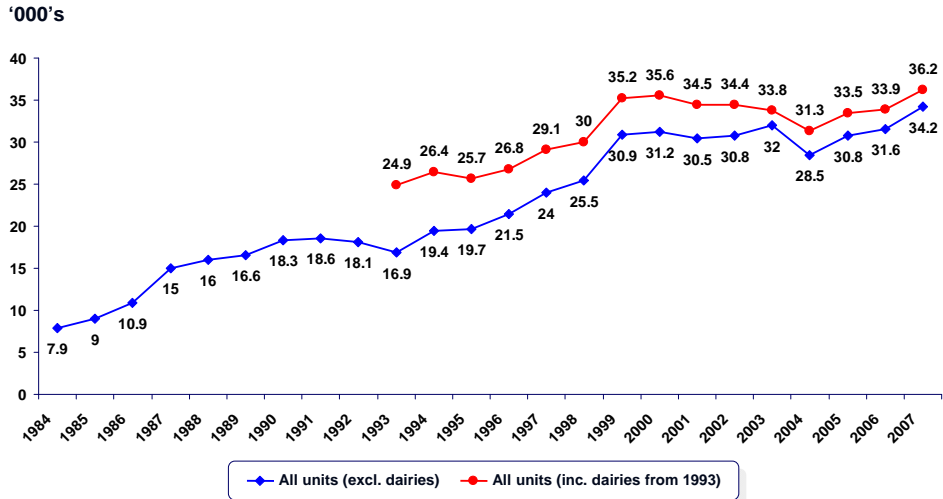
Figure 2: System Level Churn – 5 year Comparison



System growth may be steady but the increase in the number of franchised units has advanced strongly. 2007 unit growth topped 8%, to take the total number of (non-dairy) franchised units in the UK to 34,200, the highest number recorded in the 24 years of the study, surpassing the previous high of 32,000 recorded in 2003. It seems clear that while there may be a declining rate of new system entrants, businesses already operating franchised models are confounding their own pessimistic predictions (see 2007 study) and expanding their franchised operations.

Dairy UK reports an estimated 7,000 roundsmen in the UK, of which around 2,000 are franchised. Industry sources attribute the decline in doorstep milk delivery to continued changes in lifestyle and consumption habits, along with supermarket expansion. In the late 1980s, 80 per cent of milk was sold by milkmen. Today, at a time when supermarkets dominate grocery sales, the figure is around 10 per cent. However, there is an increasing trend in non-milk deliveries.

Figure 3: Number of UK Franchised Units

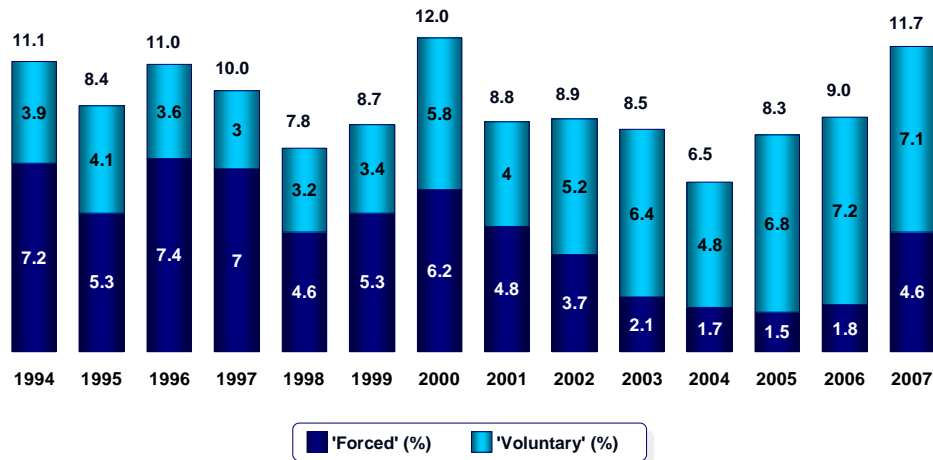


N.B. From 1993, Dairy Franchisees listed separately
 N.B. In 2004 Zurich business model changed, removed from sample (4000 Units)

The majority of franchised units began trading as franchises from the outset. An estimated 5,600 franchises were converted from company owned units (managed directly) or previously independent businesses recruited by a system.

The overall increase in the number of franchised units conceals an increasing rate of churn that stands in contrast to the stability found at the system level. In 2007 the percentage of units experiencing change reached 11.7%, some 2,220 units, the highest level since 2000. The bulk of this increase is driven by commercial failure, which has increased by more than threefold in a year, from 398 units to 1,328; slower consumer spending and tougher trading conditions are having a strong impact despite continued general optimism in the industry.

Figure 4: Proportion of UK Franchised Units Experiencing Change



Voluntary change has gradually been increasing over the last four years and with an ageing franchisee population this is predicted to become an established feature as the 'first generation' of franchisees look to realize their investments. Last year, 4.2% of franchised units changed hands specifically as a result of franchisees retiring or realizing their investment.

Figure 5: Unit Changes Reported by Non-Dairy Franchisors

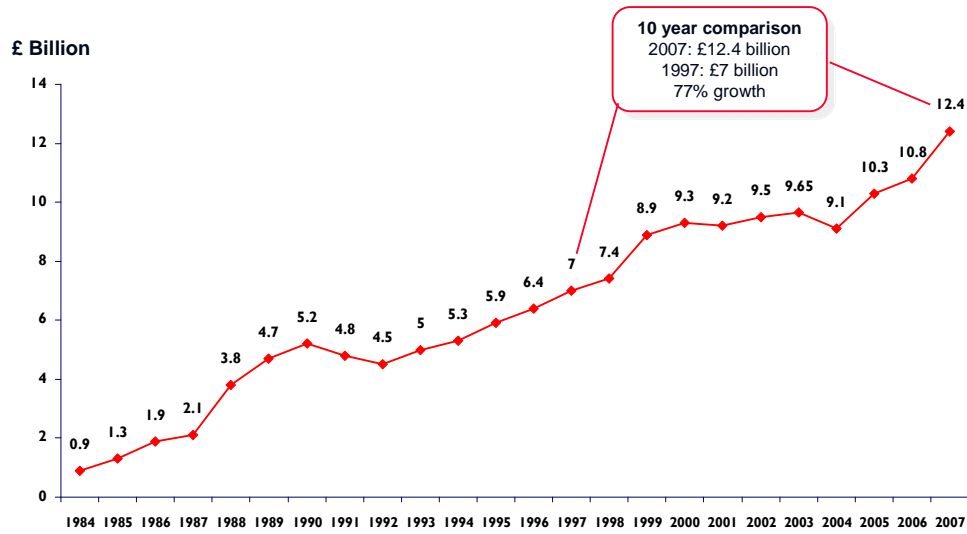
	Changed Franchisee	Bought Back	Closed Down	TOTAL	% All Units
All Reasons:	2,220	501	1,007	3,728	11.7
Commercial Failure	586	375	367	1,328	4.1
Dispute	70	8	78	156	0.5
Realising Investment	745	16	62	823	2.7
Retirement	374	8	94	476	1.5
Ill health/Domestic	257	78	156	491	1.5
Other reasons	187	16	250	453	1.4

1.2 The Economic Contribution of Franchising

Franchising has grown rapidly over the last 10 years and now makes an important contribution to the UK economy. In that period the estimated economic contribution of the franchising industry has increased from £7 billion to £12.4 billion (calculated using the estimate for mean unit turnover).

To place this achievement in context, franchising outstripped growth in the UK economy as a whole for the second year running. In 2007, national GDP grew by 3.1% compared with an impressive 15% growth in the total turnover of the franchising industry. As government (Office of National Statistics) data indicates that economic growth is slowing, the strong performance of franchising is a positive for the economy.

Figure 6: Business Format Franchising Turnover



Franchising systems operate across a broad range of industry sectors and vary in scale from major hotels and high street stores to part-time sole traders. Therefore, average turnover figures for the franchise industry as a whole conceal a wide variation and are sensitive to change.

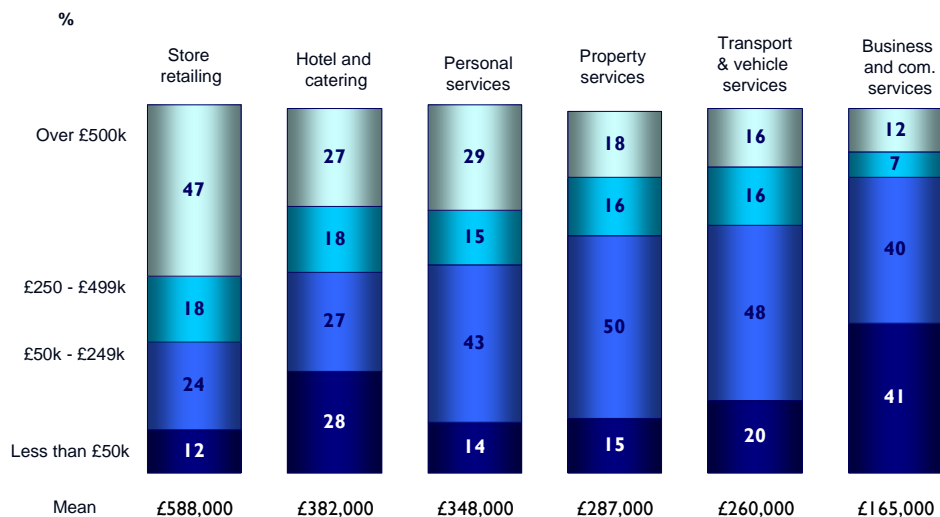
The average turnover of franchised units in 2007 is now estimated to be £360,000, an increase of 11%. Nearly a quarter of franchisees report a turnover in excess of £500k, compared with roughly a fifth last year; 2007 was clearly good for many franchised businesses. It is testament to the strength and diversity of the franchising model that while a nearly a third fall into the high turnover bracket, a fifth clear less than £50k annually. Franchising has succeeded, in part, by being a broad church open to all shapes and sizes of businesses.

Figure 7: Distribution of Franchised Units' Turnover



Store retailing continues to perform strongly, again posting the highest average sales of £588,000, followed by Hotel & Catering (£380,000) and Transport & Vehicle Services (£348,000). Business & Commercial Services remains the smallest sector by average turnover, with two-fifths of the franchisees selling less than £50,000 annually. It should be noted that these figures are based on three year averages to dampen data fluctuations due to the relatively base sizes at a sector level.

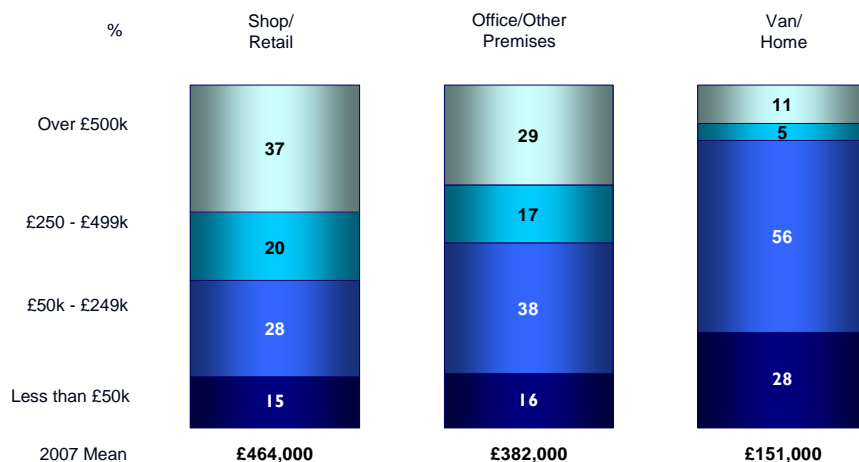
Figure 8: Annual Turnover of Franchise Units by Sector



*Based on a 3 year average. Figures rounded to nearest 1,000

As might be expected given the strength of the Store Retailing sector, franchisees operating from a shop or retail premises report the highest level of turnover at £463,900. Conversely, those operating from a van or from home clearly make up the bulk of the smaller franchise units by turnover, with sales averaging £150,900. Once again figures are based on three year averages.

Figure 9: Annual Turnover of Franchise Units by Premises



*Based on a 3 year average. Figures rounded to nearest 1,000

From the franchisee's perspective, there is a slight discrepancy between the turnover achieved and the projected turnover initially predicted by their franchisors. A quarter (25%) claim they were led to believe that turnover levels would be higher than the current levels achieved.

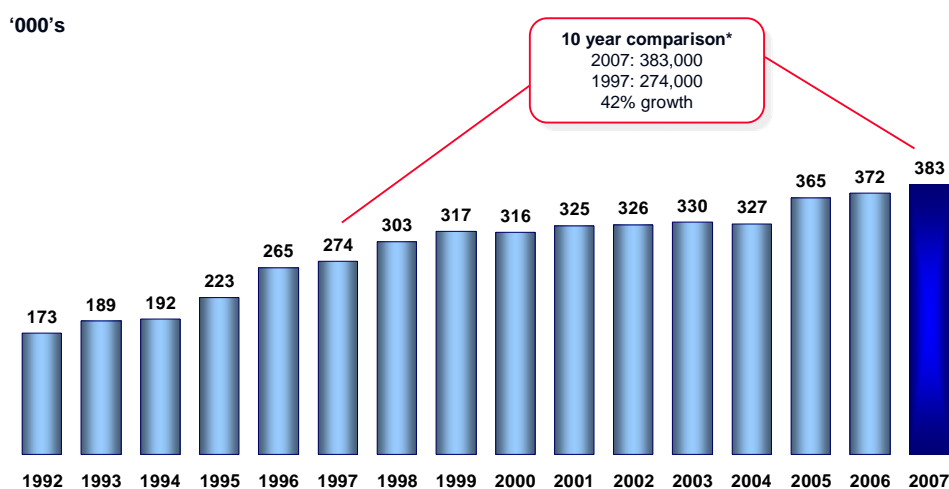
Figure 10: Actual Turnover vs. Projections



Base: All franchisees excluding 'don't knows'

The franchising industry contributes 1.3% of total employment in the UK, with 383,000 people employed out of a total working population of 29 million people (source: ONS). Between 2006 and 2007 franchising employment increased by 3%, outstripping the economy as a whole where employment grew by only 0.1% (overall unemployment fell to 1.65 million). The franchise figure includes franchisees and their partners (if actively involved in the business), unit employees, employees at franchisor system head quarters involved in the franchise, and dairy roundsmen.

Figure 11: Total Number Employed in UK Franchising



* Figures rounded to nearest thousand

Franchising continues to deliver an impressive rate of productivity growth. Whilst franchising sector employment has grown 42% since 1997, turnover has increased at almost double the rate at 77%. In financial terms, revenue per head in 1997 was £25,500 (rounded to the nearest hundred) compared with £32,400 in 2007, an increase in percentage terms of 27%. It is little wonder that franchising continues to be an attractive business model.

1.3 Expectations for the Future

For the first time in three years franchisors are bullish about the prospects for expansion. On average each franchise system operated 42 units in 2007 but expects to increase this to 44 by the end of 2008. This may not seem a significant expansion but if it were to occur uniformly it would add an additional 1,600 franchised units to the total (that is of course assuming the number of systems remains unchanged). Perhaps more importantly it shows that franchisors are feeling confident they can weather the black clouds gathering around the economy.

It is the newer franchise systems (up to 2 years old) that are planning to expand and looking to more than double the number of units they will be operating next year to 28 units on average. The established systems (3 years plus) are predicting no change going forward but even this is a more positive attitude than the study has recorded in the immediate past. Franchisors who are members of the bfa report double the number units on average than non-members with 48 and 24 units respectively.

If franchise systems continue to mature, with fewer withdrawals each year the average unit numbers per system should increase as a consequence.

Figure 12: Age of Franchise Systems & No. of Units

	% All	% Up to 2 years	% 3 – 6 years	% 7+ years
Up to 10 units	25	67	43	8
10 - 20 units	19	7	22	19
21 – 50 units	25	27	26	24
51+ units	32	0	9	49
Average number	42 units	13 units	25 units	57 units

The resale market is looking more buoyant for the year ahead, possibly reflecting continued faith in franchising and higher levels of voluntary churn. Nearly half of franchisors are expecting to offer resales in 2008 up from less than a third last year, although as the average number of resales has fallen to 3 units per system the net total is only 1,400.

Figure 13: Predicted level of Re-sales

	2006	2007
% Franchise Systems Expecting to Offer Re-sales	29%	52%
Average No. of Re-sale Units Per System	4.5	3.3
Estimated Total No. of Resale Units Next Year	1,020	1,400

Slightly fewer franchisors are offering exclusive locations this year (70%, down from 76%) while nearly a fifth are now selling multi-occupancy regions (19%, up from 13%). One in nine (11%) have no set policy on the matter and offer a mixture depending on the circumstance. Unsurprisingly, systems with more units are more likely to offer multi-occupancy regions.

Franchisors may be planning to expand but clearly they feel there are substantial barriers to overcome before they can do so. Finding the right candidates remains the most significant issue despite a slight fall on this factor from last year, especially as nearly half have experienced potential franchisees failing to turn up for interview (see section 1.4 for more details). Beyond this, franchisors are clearly planning a more cautious policy of expansion perhaps reflecting concerns over the poor economic conditions, a lack of investment capital and more broadly an industry that is more mature and developed.

Increased concern over the economy is a clear and notable change. In 2006, only one in eight were worried about the economy compared with a third this year. This is understandable given the stream of negative headlines and economic indicators in the media, and on the face of it, it is surprising that so many franchisors are planning expansion at all. However, looking at the data more closely, far fewer franchisors are worried about their own markets; only about one in seven believes their own market is static or declining, largely unchanged on 2006. This fits with the general pattern of forecasts that franchisors provide in this study: pessimism about the economy coupled with optimism about their own prospects.

Figure 14: Barriers to Growth in UK Franchised Units

Prompted list		2006
Lack of suitable franchisees	65	71
Wish to expand steadily/slowly	44	36
Poor economic conditions generally	32	12
Lack of investment/financial backing	26	33
Lack of suitable sites for franchisees	25	29
Competition from similar franchises	21	28
Lack of available franchise areas	20	26
Static/declining marketplace	15	14
No desire to expand further	14	15
Red tape/bureaucracy	13	19
Loan guarantee schemes not available	13	-
Rent increases	11	12
Planning laws	8	-

Base: All franchisors

I.4 Recruitment of Franchisees

Franchisors are increasingly employing the internet to overcome the problem of locating and recruiting suitable franchisees. The web accounts for the top three methods of recruitment, while the importance of 'traditional' methods such as the media and exhibitions continues to slide. In particular, franchisors appear to be investing in their websites as a means of generating recruits as well as forging links with external sites including the bfa (note: this question was prompted from 2006, therefore data is not directly comparable prior to this).

Figure 15: Most Useful Recruitment Channels

Prompted list		2006
Own System's Website	88	65
bfa Website	60	55
Other Franchise Website	56	56
Magazine Advertising	48	52
Newspaper Advertising	30	31
Word of Mouth	29	15
Exhibitions	26	40
Mail Shots	20	17
Seminars	13	18
Intermediaries/Brokers	13	18
Non-franchising Website	7	n/a

Base: All franchisors

The web has opened up a wealth of recruitment opportunities and in the last 12 months franchisors hit an assortment of different industry sites. The bfa.org is the most widely used site, followed by whichfranchise.com and a long list of alternatives all utilized by a sizeable proportion of franchisors. Nearly nine in ten (88%) franchisors, who are members of the bfa, have received a recruitment lead from the association's website over time, and over a quarter receive them on a regular basis (27%). Two-fifths (43%) of those receiving leads, and a quarter of all franchisors (28%) have successfully recruited one franchisee per system in the last 12 months (average 1.09), approximately 250 new franchisees in total.

Technology is not the only solution though, and franchisors employ a variety of methods in their recruitment process. 81% use 3 or more separate channels in order to spread the net wide in their search for franchisees; this is an increase on last year and suggests that franchisors are actively addressing the recruitment problem. Interestingly, for the first time in 7 years, word of mouth recruitment has increased. Does this perhaps reflect franchisors' willingness to use any channel to find the right person at a time when the available pool of talent seems relatively low (according to franchisors' perceived barriers to expansion)?

The recruitment market may be challenging but franchisors are quick to make up time once the right person has been found. Start up times are getting faster year on year and it now takes just under two months to get a new franchisee up and running. Coupled with an average four month recruitment period it now takes just 6 months (down two weeks on last year) to get from planning to the operational stage.

It should be noted that the average conceals a great deal of variation, reflecting the wide diversity of franchise systems; the process can take anywhere from two weeks to over a year.

This variation is clear when looking at the average start-up time per sector:

Hotel & Catering.....	7.7 months
Store Retailing	7.4 months
Personal Services.....	6.5 months
Business & Communications Services.....	5.8 months
Property Services	4.8 months
Transport & Vehicle Services	4.2 months

Overall, start-up times have improved in all franchising sectors compared to 2006. Services tend to have a shorter start-up time compared to those that are property based. Relatively small base sizes can lead to some fluctuations in this data but the trend has been broadly downward over the past three years.

On average, franchisors interview 8 people before they find the right candidate, slightly down on last year, possibly reflective of a tougher recruitment market; bfa members interview 10 applicants on average compared to 5 for non-members. Given the difficulties finding suitable franchisees, the

additional leads generation through the bfa has to count as a significant advantage in helping franchisors find the right blend of skills and commitment that they look for.

Franchisors apply strict financial, skills and attitudinal criteria to any potential franchisees before granting them a franchise. Whereas in the past a lack of capital stood out as the main reason for rejection, there is now very little to divide that solid financial condition from the less easily quantifiable requirement to show that the franchisee has a business brain and the right sort of attitude. It would seem that in many instances franchisees rule themselves out by failing to turn up to appointments, dress appropriately or fill in the forms correctly.

Figure 16: Main Reason for Not Granting a Franchise



Base: All franchisors

Franchisors were asked this year whether the recent age discrimination legislation will impact on the age profile of people who consider franchising as a career move. It reflects the existing ease of accessibility and appeal of franchising that only one in twelve (8%) franchisors expect a change in the profile of recruits, with nearly all of those claiming that it will increase the number of older to middle-age applicants (7%). Only 1% believe it will open franchising to a younger audience.

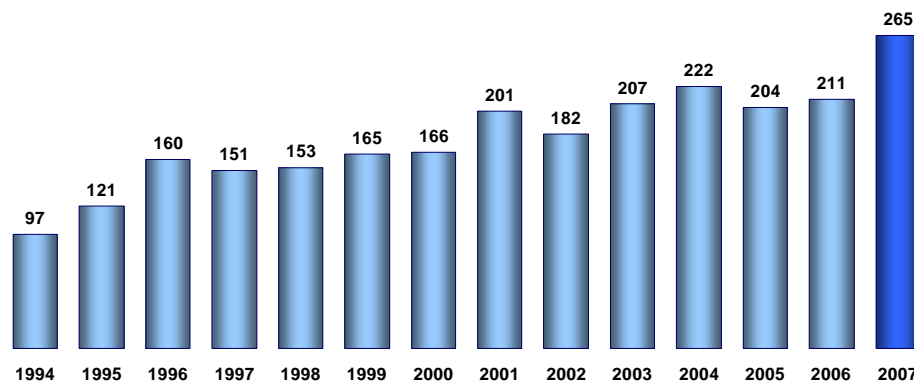
1.5 International Operations

The number of franchise systems maintaining an international presence increased significantly on previous years. In this year's study an estimated 265 systems, 33% of the total, control additional operations outside the UK. The strength of the pound for much of 2007 may have encouraged franchisors to expand while their purchasing power was strongest.

Hotels & Catering continues to be the lead sector for international operations. The rise in Business and Communication Services systems operating abroad may relate to the ability of remote service providers to trade abroad with little capital compared to actually operating in a foreign country.

The most common method for administrating these units is via a master licence (51%), with just over a third (37%), favouring direct control. The remainder have opened an overseas office (13%) or started a joint venture with another company (7%).

Figure 17: No. of UK Franchise Systems with International Operations



Base: Franchisors (151)

Europe remains the favoured destination for franchisors, with three in ten (30%) claiming to operate on the continent. As the bulk of UK trade is with the EU it is hardly surprising that franchise systems should focus on the 'local' market. Ireland is the main EU destination with nearly one in seven (15%) franchisors operating units there, followed by France (4%), Italy (4%), Germany (3%), Spain (3%) and Scandinavia (3%). A further 5% operate elsewhere in Western Europe with the same percentage trading in Central and Eastern Europe.

Further afield, the US and Canada, Australia and New Zealand bounced back somewhat after a marginal fall last year (6%, up from 4% last year). The US in particular remains suppressed compared to historic levels, possibly influenced by the threat of a US recession.

The number of franchisors planning to, but not already, operating overseas is down on last year at three in ten (29%) compared with over a fifth the year before (43%). On the face of it this appears disappointing but given the level of expansion that occurred in 2007, many of those who were planning overseas units brought those plans to fruition.

Encouragingly, all the key perceived barriers to expansion abroad have declined in significance between 2006 and 2007. Legislation, a lack of suitable franchisees and language are the main barriers but in each case they are below the levels registered a year ago. This may reflect the fact that few of those systems not already operating abroad have clear plans to do so (4%) and therefore such issues are slightly abstract.

Figure 18: Barriers to Growth in International Franchised Units



Base: All franchisors operating or planning to operate abroad (79)

1.6 The Broader Context of Franchising

The inclusion of businesses in the main market sizing estimates and other data is based on two business criteria:

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

There are many businesses falling outside the close remit of this study that display significant characteristics of franchising. These industries 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.) A summary of these businesses is included here in order to show the wider influence of franchise-related concepts.

The National Franchised Dealers Association estimates that there are 14,000 car outlets (including second hand) operating in the UK and the number of those which are franchised is around 5,500; the lowest since records began in 1976. Despite this the Society of Motor manufacturers and Traders (SMMT) figures indicate that new car registrations grew by almost 3% to 2.4 million exceeding the forecasts at the start of 2007 by 90,000. Increased competition in the car markets has driven the average price of a new car down from £9,827 to £8,851 at the end

of 2007. From these figures the value of the franchised new car market is valued at an estimated £22 billion, of which franchised outlets account for £9.8 billion.

This growth is not expected to carry on into 2008 due to current economic conditions, and SMMT predict sales to reach 2.34 million over the coming 12 months. AA Personal Loans found that 20% intend to buy a car in the next 12 months, a drop from 25% last year.

In addition to car dealerships, a small number of motorcycle dealers are exclusive to one manufacturer, and therefore are similar to franchised businesses. The Motor Cycle Industry Association (MCIA) report that the number of new motorcycle (motorbike and scooter) registrations for 2007 was 144,583. This is an 8.6% increase from 12 months ago when registrations were maintaining a steady growth. No data is available for the average price of a UK motorcycle this year but assuming that last year's price (£4,900) has increased by inflation only, then the estimated value of the UK motorcycle market is £720 million.

According to the United Kingdom Petroleum Industry Association (UKPIA) the number of petrol filling sites in the UK has been declining by 600 sites per year on average, taking the number of filling stations to 9,382 at the start of 2007. This decline has taken the number of sites to a quarter of the 1970 total, due to the demise of the independent trader and the proliferation of supermarket sites. Out of town sites and lower overhead costs per litre sold are the main factors forcing smaller sites out of this industry. At the start of 2007, supermarket filling stations accounted for 1190 sites in the UK, 13% of which were owned by the supermarkets themselves, but having a market share of 40%. Estimates from the UK Petroleum Industry Association put the number of petrol station retailers that are similar in format to franchised units at roughly half this figure, although there is no firm data to support this.

The British Beer and Pub Association (BBPA) report that the UK beer and pub sector consists of 58,000 pubs, of which 30,800 are tenanted/leased, and is responsible for employing over 600,000 people. This sector is now at its lowest level since 1969 but is not alone in experiencing a decline in sales over the last 12 months, coinciding with the smoking ban introduced in July. The proportions of pub ownership remain similar to that last year with the majority being tenanted/leased (54%), 16% managed, and 31% run independently. The BBPA estimate that the turnover of the public house sector for 2007 was £21 billion, a decline of 13% from 12 months ago.

2. The Character of Franchising

2.1 Franchising Structure

Over the past nine years franchised businesses have been classified in this study according to the categories developed by the European Franchise Federation (EFF). Over this time there have been a number of shifts in the structure of the franchising industry with regard to these categories.

As noted in Section 1, there has been a 3.5% increase in the number of franchise systems in operation, taking the overall total to 809 active systems in the UK. Breaking this figure down using the EFF sector categorization shows that over the last year, Property Services experienced proportionately the largest growth (+7%), whilst the withdrawal of one system from the Business & Commercial Services category resulted in a small decline.

Looking across a longer time period, over the last seven years system growth has been powered by Personal Services (39%) and Property Services (62%), whilst other sectors have been relatively static or experienced much lower levels of growth. This reflects the property boom, including property as an investment, and the relatively lower barriers to entry that both sectors exhibit.

Figure 19: No. of UK Franchise Systems by Category

Excludes dairies

	2000	2001	2002	2003	2004	2005	2006	2007	% Change on 2006
Hotel & Catering	116	114	113	117	112	109	108	115	6%
Store Retailing	91	86	86	89	91	97	101	101	0%
Personal Services	114	113	111	110	131	144	153	159	4%
Property Services	125	140	147	152	165	182	189	202	7%
Transport & Vehicle Services	75	76	72	76	64	66	70	73	4%
Business & Commercial Services	141	140	145	152	152	158	157	156	-1%
TOTAL	662	666	674	692	715	756	778	806	+3.5%

Property Services is now comfortably the largest sector by systems, accounting for a quarter of all systems, although Hotel & Catering remains the largest sector in terms of franchise units, accounting for nearly a quarter (24%) of the total. For the third year in a row systems in the

Business & Commercial Services sector have consolidated with fewer systems but more units per system.

Figure 20: No. of UK Franchise Units by Category

Excludes dairies

	2000	2001	2002	2003	2004	2005	2006	2007	% Change on 2006
Hotel & Catering	7,120	5,655	5,800	6,395	6,380	7,050	7,450	8,100	+9%
Store Retailing	4,200	3,760	4,260	4,390	4,580	4,785	4,860	5,100	+5%
Personal Services	3,315	3,435	4,125	4,540	4,280	4,740	4,950	5,900	+20%
Property Services	4,440	5,560	5,260	5,545	6,175	6,535	6,575	6,650	+1%
Transport & Vehicle Services	3,470	3,520	2,700	2,545	2,410	2,575	2,560	2,925	+14%
Business & Commercial Services	8,655	8,570	8,650	8,590	4,740	5,075	5,205	5,525	+7%
TOTAL	31,200	30,500	30,795	32,005	28,565*	30,760	31,600	34,200	+8%

*Note: withdrawal of Zurich

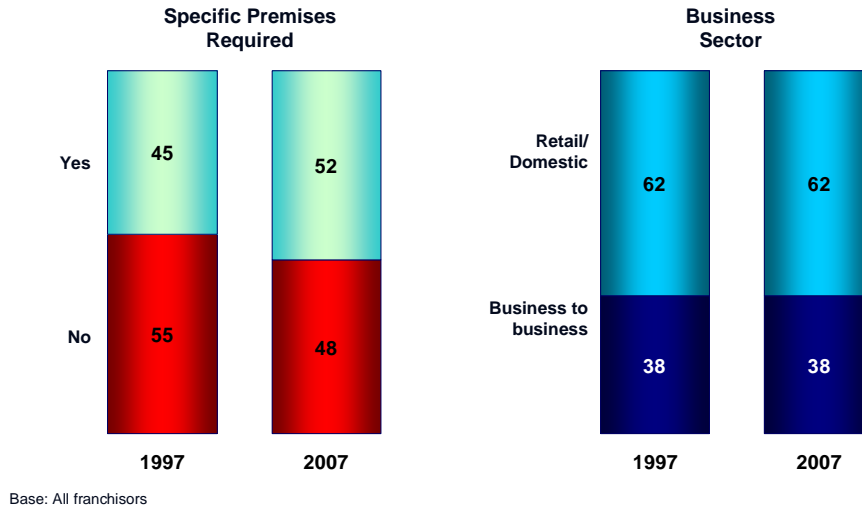
The units per system have increased in 2007 across the board, but particularly for Store Retailing where the 'average' system has risen from 32 to 37 units. Property Services is the only sector experiencing a decline in the number of units overall, a fact that can be explained by the large number of new entrants in this sector.

Hotel & Catering70 units
 Store Retailing.....51 units
 Transport & Vehicle Services.....40 units
 Personal Services.....37 units
 Business & Communications Services.....36 units
 Property Services37 units

52% of the franchise systems require specific premises to operate the business, with the remaining 48% operating remotely (e.g. man with van) or out of their homes. Where specific premises are required, almost three in ten (29%) franchisors act as landlords to their franchisees, up slightly on 2006 (28%). The inconsistent interest rates of 2007 have made renting a more favourable option for franchisees, thus contributing to the slight increase in tenants.

If we compare 2007 figures with 1997 figures, we can see that there is difference in the retail / business to consumer franchise split over this time period. However, the withdrawal of Zurich in 2003/2004 masks an accelerated growth in consumer focused franchises.

Figure 21: Structure of Franchising Activity



Over the last decade there have been marked changes in the ownership of franchise systems. The number of franchise systems based in the UK has risen by 66% to 621 and this trend is likely to continue as nine in ten (91%) of new entrants are home grown systems. In the same period the number of franchises that are the subsidiary of a parent company (mainly based overseas) fell by 32%, while the number of Master Licensees has increased substantially. Among these, 71% are owned by US or Canadian companies, 10% Australasian and 18% UK owned (up from 5% in 2005).

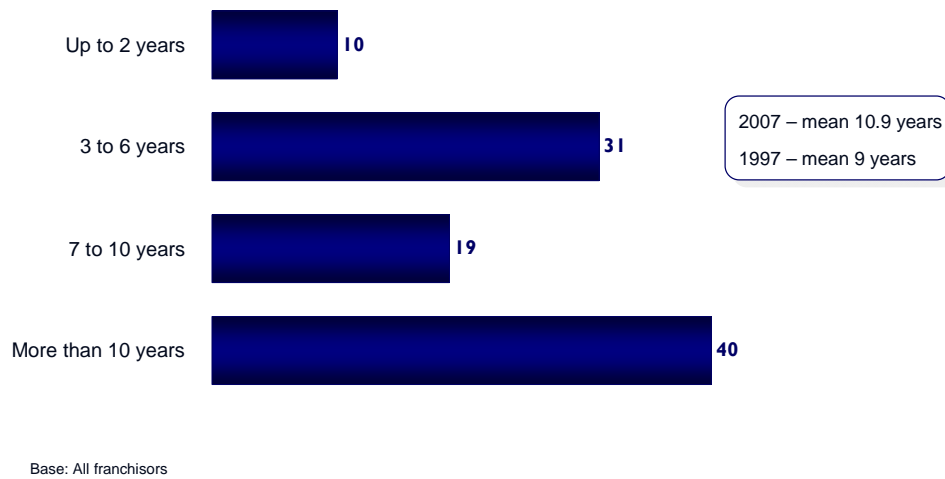
Figure 22: Type of Franchise System

Excludes dairies

	1997		2007		Change since 1997	
	Count	%	Count	%	Count	%
Ultimate owner of the system	375	66%	621	77%	+246	66%
Subsidiary of parent company that owns the system	142	25%	97	12%	-45	-32%
Master Licensee of another company that owns the system	51	9%	89	11%	+38	43%

The average age for a franchise system is 11 years. Logically, franchise systems that have been operating for a longer period of time typically have more units; the average age for franchises with up to 20 units is 8 years and for those with 21 and more units it is over 13 years.

Figure 23: Average Age of UK Franchise Systems



Transport & Vehicle Services and Retail Store sectors are the most established on average, although there is very little difference between them and Hotel & Catering and Business Communication Services (11 years). Property and Personal Services are the youngest sectors reflecting the substantial increase in units that has occurred in each sector over the last seven years (see above).

Transport & vehicle services.....	12 years
Store retailing.....	12 years
Hotels and catering.....	11 years
Business & communication services.....	11 years
Property services.....	10 years
Personal services.....	9 years

2.2 Regional and Sector Contribution

Franchise systems are increasingly spreading out across the UK, with higher levels of representation in all regional areas compared to ten years ago. Historically, franchising systems have had their strongest presence in London and the South East, the West Midlands, the North West and the South West, to which Yorkshire and the East Midlands should be added now.

Recently, weaker areas (NI and Wales) have been experiencing growth, so franchisors may be rolling out their operations from stronger markets. This trend may well continue as franchising is adopted by regional development agencies (and LEGIs) as a means for stimulating regeneration. There has been recent activity in Scotland, Great Yarmouth, Sheffield and Croydon (S London) in this regard (source: BDRC primary research).

It takes time for increased system representation to impact on the regional distribution of units. The South East and South West consistently register the highest number of units per head of population but early advances can be seen in Yorkshire, East Midlands, Wales, and Scotland.

Franchising now contributes over £1 billion to the local economies in seven of the twelve UK regions. While implied regional turnover is a very rounded measure it clearly demonstrates the economic importance of franchising in the UK.

Figure 24: Regional Distribution – 3 Year Average

	Regional Presence of Franchise Systems			Regional Distribution of Franchise Units		Implied annual Turnover from Franchising £ billion
	Total		New Systems (up to 2 years old) 2005-2007 %	Total 2005-2007 %	Indexed on UK Popn.* %	
	1995-1997 %	2005-2007 %				
London	67	74	57	12	100	1.5
Other South East	77	83	62	20	145	2.6
South West	63	75	47	13	159	1.6
East Anglia	54	63	29	3	36	0.4
West Midlands	67	79	57	7	82	0.9
East Midlands	60	69	31	8	113	1
North West	65	76	47	10	90	1.3
Yorkshire	55	72	38	8	95	1
North/North East	54	62	27	5	109	0.6
Wales	48	56	25	5	95	0.6
Scotland	55	61	36	8	97	1
Northern Ireland	33	42	19	1	47	0.1

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

2.3 Franchisee Characteristics

The maturing of the industry is testified to by the marked change in legal status. This year 49% of franchisees are operating as limited companies, more than double (21%) ten years ago. The increase in limited companies can be linked directly to a tax perk that the Government offered (2004/5), making the first £10,000 of profit tax free for incorporated companies; the perk was subsequently withdrawn. Sole traders and partnerships account for 36% and 15% respectively of all operating franchises.

More franchisees own multiple units than last year. Just over one fifth (22%) claim to be operating more than just one unit, averaging seven units each. The Hotel & Catering sector report the highest levels of multiple unit ownership at 49%, while the Business & Communication Services sector with the lowest level at (8%) reflects the fact that one unit in this sector may have a wide geographical reach.

Figure 25: Franchise Unit Ownership by Unit Status

	All Units %	Sole trader %	Partnership %	Limited company %
Multiple Units	22	13	19	31
Single Unit	78	87	81	69

Franchisees are holding their businesses for longer with the average age now 7.2 years compared to 6.7 last year and 5.5 years a decade ago. This reflects successful business development by franchisees in a time largely positive economic conditions over this period (low interest rates, low inflation). Wales boasts the oldest businesses with 9.3 years, out-lasting London based franchises by just under a year (8.4 years); Scotland and Northern Ireland, regions of recent franchise expansion, have the youngest franchise businesses with an average of 5.2 years.

Limited company franchises are no older than their sole trader counterparts on average, but they are more successful businesses in terms of turnover (£495k compared with £195k). Limited companies, by virtue of their legal set-up, find it easier to secure investment capital which can be used to drive sales and ultimately expansion.

3. Business Set-up

3.1 The Profile & Business Experience of Franchisees

Historically, franchising has been a white, male dominated industry but beneath the headline figures change is occurring. Women make up over a third of new recruits entering franchising in 2007 compared with an eighth ten years earlier. Change in the overall balance will be gradual, given the relatively low level of new entrants each year but the early impact can already be seen. Female representation is being driven by the growth in the Personal Service sector, where women make up 61% of franchise owners.

Ethnicity is another area where change is occurring. A quarter (25%) of new entrants are of Asian background, with the majority of those coming from the British Indian community. The Asian community is well known for the emphasis it places on entrepreneurial skills, as testified to by the number of people of Asian origin that make it into Britain's rich list each year. This community is a valuable source of new recruits for the franchising industry. Less positively, the Black community seem woefully under-represented in franchising with less than 1% being of Black/African origin.

As the industry becomes more mature, the last decade has seen a steady ageing in the profile of franchisees. Whereas ten years ago an eighth of franchise units were run by people under thirty years old, this is now down to just 6%. At the other end of the age scale, there is a simultaneous fall in the number of 50+ franchisees, as increasing numbers reach retirement age and realise their investments. Therefore, while the average age is increasing, the age distribution is narrowing leaving franchising more uniformly middle-aged.

The fact that franchising is attracting a more mature type of second or third career new entrant is exacerbating the trend towards a more middle-aged industry. The average age of new recruits may have dipped slightly but the proportion of new entrants under 30 years old has halved since 1997, while nearly a third are now between 41 to 50 years old. This trend should not be seen as a negative development; older recruits bring with them a blend of skills, experience and greater financial muscle that younger recruits will struggle to match. It seems fitting that franchisors are looking for and attracting an older applicant when the main barriers to granting a license are a lack of capital and business acumen.

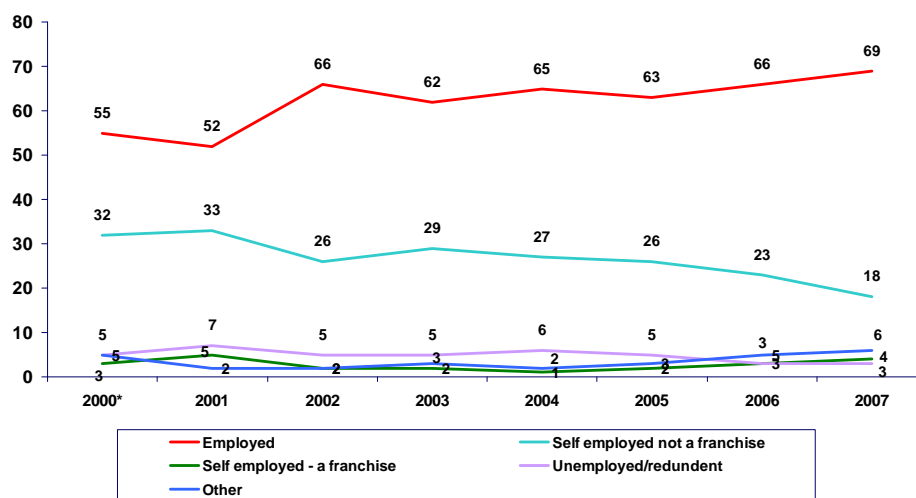
Figure 26: Profile Characteristics of Franchisees

	All Franchisees		New Recruits - all held Franchise 2yrs or less	
	1997	2007	1997	2007
AGE:	%	%	%	%
Up to 30	12	6	26	13
31 – 40	23	24	27	28
41 – 50	34	44	18	32
Over 50	30	26	28	27
Typical (mean) age	43	47	44	43
STATUS:				
Married	83	86	71	86
Single	17	14	29	14
RESPONDENT GENDER:				
Male	80	75	88	66
Female	20	25	12	34
ETHNIC ORIGIN* :				
White – British	n/a	80	n/a	69
White – other	n/a	9	n/a	4
Asian – Indian	n/a	7	n/a	15
Asian – other	n/a	5	n/a	12
Middle Eastern	n/a	2	n/a	-
Black – Any	n/a	*	n/a	-
QUALIFICATIONS				
None	19	18	22	22
Up to 'O' Level/GCSE	29	24	21	18
'A' Level	13	14	21	11
C&G/Trade	22	4	14	-
OND/HND/Dip	8	8	8	12
Degree	8	30	12	32
MBA	1	3	2	5

* Too small – less than 1%
Ethnicity was not asked in 1997

Franchisees typically came from salaried employment prior to entering the franchise industry. Franchising is sufficiently supportive for applicants to feel they can make a safe transition from the security of paid employment to running their own business with no previous experience of doing so. Those who have been self-employed outside of a franchise operation have seen a steady decrease since the turn of the century as more potential candidates are lured by the attraction and possible rewards associated with running their own franchise.

Figure 27: Working Status Prior to Joining Franchise Industry

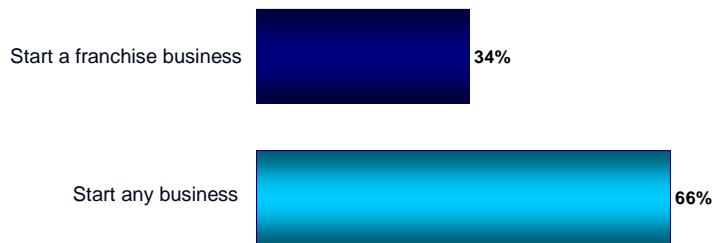


Base: All franchisees who had not previously worked as an employee of the franchise

3.2 Actions Taken before Setting-up Business

The franchise industry attracts a large number of potential entrepreneurs who see franchising as a viable alternative to setting up their own business. Two-thirds of current franchisees began with a desire to start a business rather than specifically a franchised unit. On one level this and other research conducted by BDRC on behalf of the bfa (*Entrepreneurs & Franchising*, September 2005) identifies low initial awareness as a barrier to franchise take-up. However, the findings also show that franchising is appealing as a business model to attract those who had not previously considered it as an option.

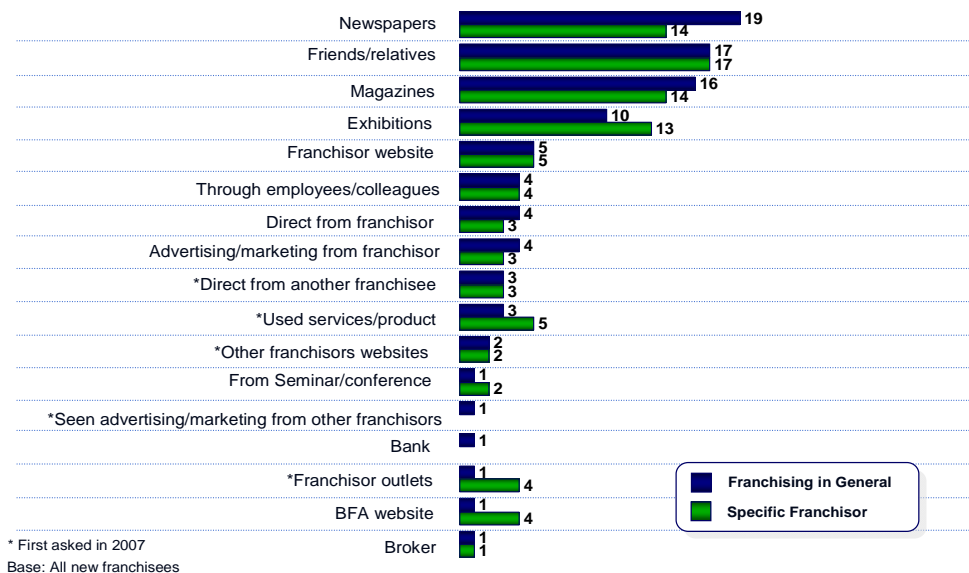
Figure 28: Franchisees' Business Start-up Plans



Base: All franchisees who had not previously worked as an employee of the franchise, excluding don't knows

Franchisors may report that their and the bfa's websites are crucial in the recruitment of franchisees, but for franchisees themselves their first step into franchising is invariably less exact. The traditional methods; newspapers, magazines, exhibitions and the opinions of friends and family, are the catalysts for further investigation both of the industry and a specific franchise system. A fifth (22%) of franchisees received a free copy of the bfa information pack before they took out their franchise.

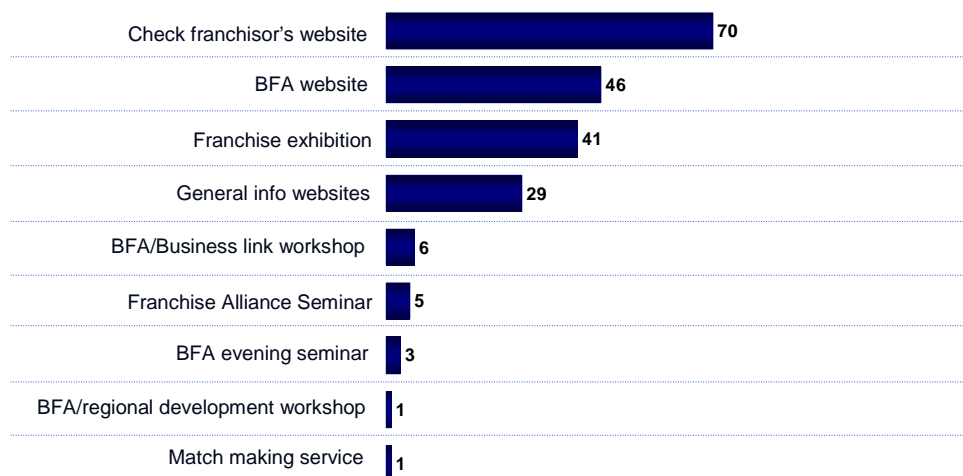
Figure 29: Franchisees' Information Channels



Far from suggesting that franchisors are wasting money investing in websites and online recruitment, this finding shows that a variety of methods need to be employed firstly to raise awareness (traditional media) and then direct an individual into the recruitment process (online). Franchisees' interest is alerted by reading a newspaper or discussing the matter at home; they then may visit the bfa's and franchisor's own websites and to a lesser extent, an exhibition to take that interest further and look into the recruitment process.

Base sizes are too small to chart the attendance figures for the main franchise exhibitions but the National Franchise Exhibition (Birmingham NEC) and the British and International Franchising Exhibition (London Olympia) are the most popular mentions.

Figure 30: Action Taken Prior to Acquiring a Franchise



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

New franchisees split almost evenly between those who only seriously considered one franchise (48%) and those who shopped around (52%). Those who shopped around looked at eleven systems on average, half of which were outside their ultimate sector of choice (48%). There is a great deal of variation by sector: almost all (96%) in the property services sector looked at alternatives whereas those involved in personal services and store retailing tended to look at just the one franchise (67% and 62% respectively).

The single most popular reason for selecting a franchise is the growth potential of the business, as franchisees are leaving their existing situations and seeking to establish a successful franchise operation. It should be noted though, that no single reason applies to a majority of franchisees. The strong suggestion is that franchisees are looking for success and security (well known brand, affordable, etc) but also that the franchise selection is a personal decision which people make based on their own knowledge, circumstance and feelings (interest in the field, best suited to me, location, liked the people, etc): while mainly a decision made with the head, the heart still contributes.

Figure 31: Reasons for Selecting a Specific Franchise

		2006	2005
Growth potential	23	33	23
Well known brand	19	21	12
Affordability	12	9	22
Interest in field of business	12	3	13
Best suited to me	8	6	-
Existing franchisees successful	6	17	8
Location of business	6	1	6
Specialist business knowledge of franchise	6	4	2
Liked the people	5	3	3
Low risk	4	14	4
Available support	3	16	9
Family support	1	3	2

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

Franchisees are more likely to conduct their own research rather than seek out or pay for professional advice. This mainly takes the form of a thorough analysis of the franchise fees and seeking out existing franchisees. When it comes to professional advice, unsurprisingly, candidates trust familiar sources, preferring their current bank and solicitor rather than parties they have not yet met.

The return and profitability of the franchise is reviewed before signing, as franchisees want to ensure that they are moving into a successful business. Three quarters find out whether the business is profitable from existing franchisees (78%) and assess whether the fees are fair and value for money (77%). Seven in ten (71%) are conscious of the impact a new business will have on their family and therefore assess whether the benefits outweigh the risks.

Figure 32: Checks Made & Advice Sought Prior to Signing Franchise Agreement

		2006	2005
Ask existing franchisee whether their business was profitable	78	81	85
Assess whether the franchise fees were fair + value for money	77	86	86
Seek advice from accountant	74	69	79
Ask existing franchisees for their opinion of the franchisor	73	81	80
Assess the impact of running the business on your family	71	70	68
Check the financial stability of your franchisor	67	63	74
Seek advice from your main bank	63	57	70
Seek advice on legal agreement from a non-bfa affiliated franchise solicitor	43	39	63
Check your franchisor is a bfa member	42	62	61
Seek advice from another bank	33	24	25
Ask whether they had operated a pilot before launching the franchise	31	40	39
Seek advice on legal agreement from a bfa affiliated solicitor	26	29	25

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

4. Finance

4.1 Franchise Charges

Setting up a franchise takes more than entrepreneurial verve; it requires a substantial amount of start-up capital to begin with. The average total start-up fee for a franchise operation (from a series of initial fees levied by franchisors) is £64,900 this year. Direct comparisons with previous years have not been made in this report due to changes in the way the data was collected this year. It is important to note that the diversity of businesses supported by the franchise format and the varied incidence of fee levying by sector means that the start-up cost is a very sensitive measure and may vary considerably from year to year.

Equipment costs, the franchise fee and working capital make up 85% of the initial start-up costs. Equipment costs, levied by three-quarters of franchisors, have been on the rise in recent years and are now the single biggest start-up expense at £23,000. The great majority of franchisors charge an initial license fee averaging £17,000, an increase of £1,700 on last year which reverses a downward trend recorded over the last few years. Most also charge for any necessary working capital (85%), and to a lesser extent, both in terms of average amount and incidence, for stock and materials (60%) and training (49%).

Figure 33: Start-up Charges Levied by Franchisor

	Incidence		Mean Amount Paid*
	1997	2007	2007
Initial Charge	%	%	
Franchise Fee	97	90	£17,000
Equipment	76	74	£23,000
Stock	58	64	£6,900
Working Capital	84	85	£15,600
Training	n/a	49	£1,900
Other Charges	n/a	16	£500

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

Hotel & Catering and Store Retailing franchise units incur the highest start-up costs, £125k and £160k respectively. The entry costs are high reflecting the nature of each industry; the cost of equipping and fitting out premises makes up the bulk of the costs, along with the cost of stocks for store retailers. In both instances start-up costs account for approximately 30% of the average annual turnover for the sector, hence initial costs take longer to recover, compared with Personal Services and Transport & Vehicle Services (10% of annual turnover). There is a trade-

off to be made, though and while the latter two sectors have driven the growth in franchised units due to the ease of entry, they account for a much lower proportion of industry turnover, relative to their unit size.

In addition to start-up costs, franchisors charge their franchisees a number of recurring fees throughout the term of the franchise agreement. The proportion of franchisees paying these charges varies according to the purpose of the fee.

Seven in ten franchisors (72%) charge a management services fee and a quarter levy a royalty charge on sales. However, both of these recurring fees are what defines a full format franchise, thus having a 97% incidence rate. In addition just over half (51%) charge for advertising and a fifth for IT support (18%). These figures are in line with last year's results.

As a proportion of sales, the charges have remained relatively consistent over the past few years. 'Other charges' and royalties are highest. However, the incidence of franchisees facing these charges is relatively low. Management service fees account for a substantial proportion of sales, averaging 7.5%, unchanged on 2006. Indications are that while franchisees in the Hotel & Catering and Store Retailing sectors face the highest start-up costs, they are able to recoup the difference in the long-run with lower recurring costs as a percentage of sales.

Figure 34: Recurring Franchise Fees

	Incidence		Proportion* of Sales, 2007
	1997	2007	
Recurring	%	%	%
Management Services Fee	72	72	7.5
Royalties	n/a	25	8.7
Contributing to Advertising	57	51	1.9
IT Support Fee	n/a	18	0.5
Other Charges	37	11	13.0

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

Nearly three quarters of franchisors (72%) supply their franchisees with stock or supplies needed to carry out their business, similar to 2006. Again, low base sizes prevent conclusive evidence, but the indication is that those in Property Services are least likely to require any stock or supply provision, as one would expect from their line of work. Most franchisors (67%) do not levy a mark up on their franchisees for these supplies, but those who do charge add an average premium of 6.2%.

4.2 Investment Finance

In view of the start-up costs already reported, it is unsurprising that the initial investment franchisees are making, including savings, working capital, borrowings and any other source of finance, has risen to an estimated £76,000 (up 11% on 2006). The Hotel & Catering Sector has the highest level, of investment at an estimated £140,000.

Given these figures, it is equally unsurprising that three in five (62%) franchisees borrowed money to fund their initial investment. The average amount of money borrowed has increased considerably over the last decade, more than doubling from around £30,000 in 1997 to just below £70,000 this year. An increasing proportion of franchisees claim to borrow more than £50,000, up from 12% in 1997 to 41% in 2007. The recent Bank of England base rate reductions will have been welcome for many franchisees that clearly have a high gearing ratio (proportion of debt to earnings).

The main source for borrowing these sums remain the banks, with over four in five franchisees (81%) turning to the high street banks for borrowing, up from just over three in four (76%) in 1997, possibly reflecting the larger amounts borrowed. Nearly all franchisees (97%) borrow from one source only rather than using a combination of sources. Friends and family remain a reliable port of call for those borrowing under £20,000, with one in five (19%) borrowing from them, as compared to just 4% of those borrowing £20,000 and up.

More than half of franchisors (56%) state they assist new franchisees in raising their initial investment, marginally less than claimed to do so last year (62%). Just one in six of those (15%) actually supply, or both arrange and supply, the initial investment, whereas 84% provide *indirect* help in arranging financial assistance. Of franchisors providing the latter assistance, nearly all (95%) turn to their bank or building society for direction.

Figure 35: Loan Amount & Sources

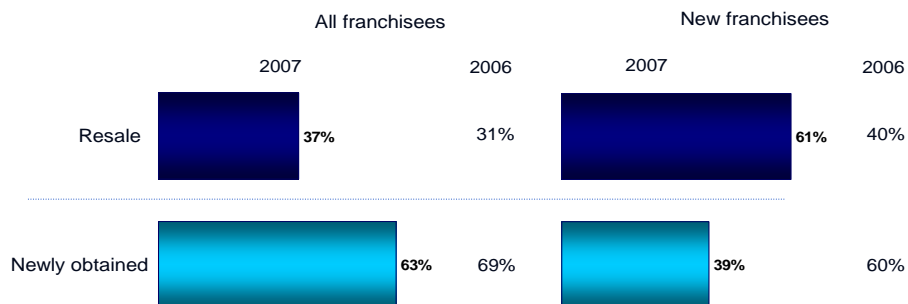
All Borrowing Franchisees		
	1997 %	2007 %
Source of loan: (more than one answer possible)		
Retail Banks	76	81
Building society	8	*
Relatives/friends	9	6
Franchisor	3	1
Finance house	1	2
Other	1	3
Value of loan:		
Up to £10,000	29	22
£10,001 - £50,000	57	37
£50,001 plus	12	41
Average amount	£29,900	£69,400

Base: All franchisees borrowing money to fund start-up
 *Too small – less than 1%

4.3 Level of Investment in Purchasing a Resale or Existing Territory or Business

Around two in five franchisees interviewed (37%) bought a re-sale unit, rather than starting it from scratch. Of those that started their franchise in the last 2 years, this figure rises to a sizeable three in five (61%), indicating this to be an increasingly popular method of acquiring a franchise. In Section I we reported that franchisors have an estimated total of 1,400 projected resales for 2008.

Figure 36: Percentage Purchasing Resale Units



Base: All franchisees

Around two in five franchisors (41%) claim franchisees acquiring a re-sale do not incur any charges from them. All costs except for working capital are lower than for a new franchisee, as reported on in section 4.1. The average total start-up costs for these incoming franchisees

amount to £52,700, substantially lower than the £64,900 start-up costs stated for new franchisees.

As may be expected, working capital is the most frequent cost franchisees face, required by 51% of franchisors, and accounts for the largest average cost at £17,000. Over two in five charge licence (46%) or equipment fees (41%). Only a third (34%) charge those buying a re-sale for initial stock or materials and quarter (26%) ask their new franchisees to pay for goodwill built up in the business.

Figure 37: Level of Investment on Resales

	Incidence 2007 %	Mean amount paid 2007
Goodwill	26	£9,100
Stock	34	£6,500
Working capital	51	£17,000
Franchise fee	46	£5,800
Equipment	41	£10,500
Other	6	£4,700
TOTAL	59	£53,700

Base: All franchisors

4.4 Costs Involved in Launching in the UK

Franchisors that have launched in the last 4 years were asked to estimate the cost involved, broken down by category. Whilst only a small proportion are eligible for this question, it does nevertheless provide a (cautious) insight into the costs involved in launching a franchise. It now costs on average £155,000 to launch in the UK, down £15,000 on last year; IT and other new technology are the main areas where costs have fallen.

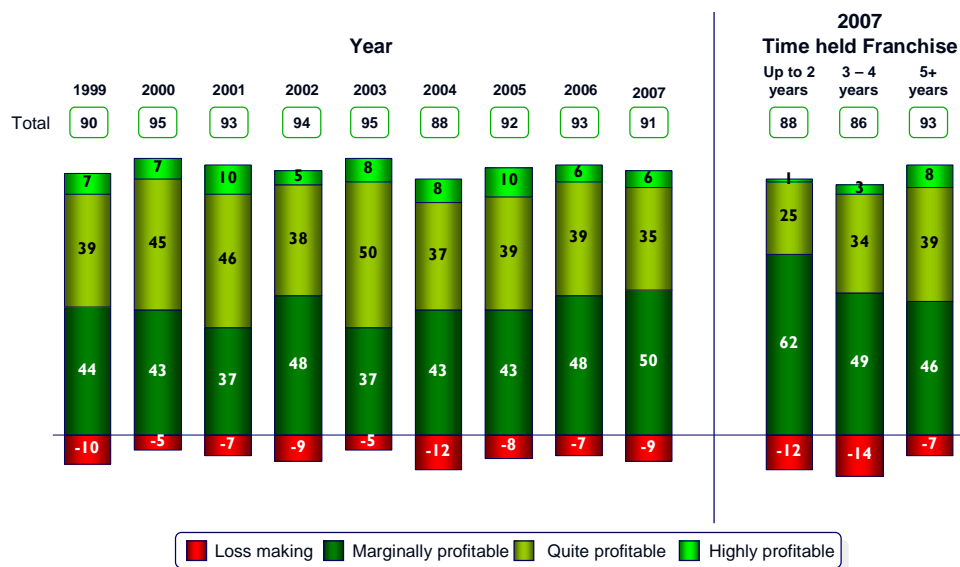
5. Performance & Outlook

5.1 Profitability

The headline profitability figures are strong and little changed on last year. Nine in ten franchisees (91%) claim their business traded profitably in 2007, just 2% down on 2006 (93%). By logical extension this means that a shade under one in ten were running at a loss.

Profit margins, though, are under pressure, a fact concealed by the headline figures. There is an evident decline in the level of profit posted; nearly half of franchisees claim to be trading at a marginal profit compared with just over two in five in 2005. With turnover levels rising, the most likely explanation is that trading costs have risen sharply. This pressure on profits may be one explanation for the increase in the numbers of franchisors who are introducing energy and waste efficiency measures this year to reduce their carbon footprint and trading costs.

Figure 40: Claimed Unit Profitability



Base: All franchisees

As in previous years, Property Services is the most profitable sector, with 97% of franchisees in this category saying they are currently profitable. Store retail units report the most disappointing figures, possibly affected by a surge in online shopping and tougher trading conditions on the high street, with 18% saying they are currently loss making, compared to 7% in 2006.

Unsurprisingly, more established franchises, as indicated by age, existence of multiple units and employment of staff, are more likely to report profits. Surviving the first two years is crucial: only 26% claim to be at least quite profitable in the first two years compared to 47% of units which

are over 5 years old. However, franchises under two years old are more profitable now than 12 months ago when 13% experienced a loss. Over one in five franchisees (22%) without employees currently report running at loss, compared to just 8% of businesses with employees.

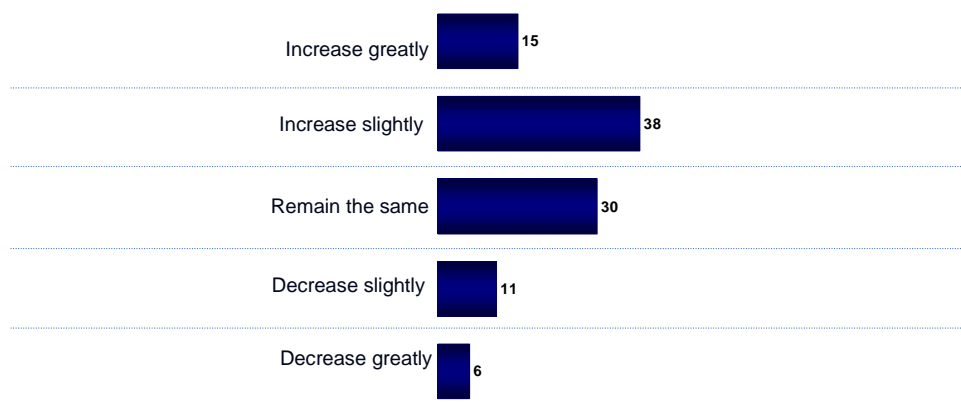
5.2 Advertising & Marketing Spend

For the first time, in 2007, the study looked at franchisors' current and intended levels of advertising and marketing spend. Over four in five (82%) franchisors currently have an advertising and marketing budget, with an estimated average spend of £49,000. This average conceals a wide degree of variation in the data; three in ten (29%) of those with a budget spent less than £5,000 compared with one in eight (13%) who spent in excess of £100,000. There is no significant difference between bfa members and non-members with advertising and marketing spend.

New franchisors, those trading for less than two years, are not underpinning the growth of their franchise operation with a high level of marketing spend at the outset. It is in fact the more established franchise systems that are spending the most. Systems trading for over seven years spent £80,000, while those who are relatively new to market spent just £10,000. Indicatively, franchisors in the Hotel & Catering, Store Retailing and Transport & Vehicle Services sectors have the highest spend levels.

If trading conditions are hardening, most franchisors are looking to respond aggressively with higher advertising and marketing spending in 2008. Half are planning to increase spending with one in seven (14%) likely to spend a great deal more on marketing. One in six (16%) claim to be reducing spending next year in a drive to cut costs.

Figure 41: Predicted Advertising & Marketing Spend in 2008



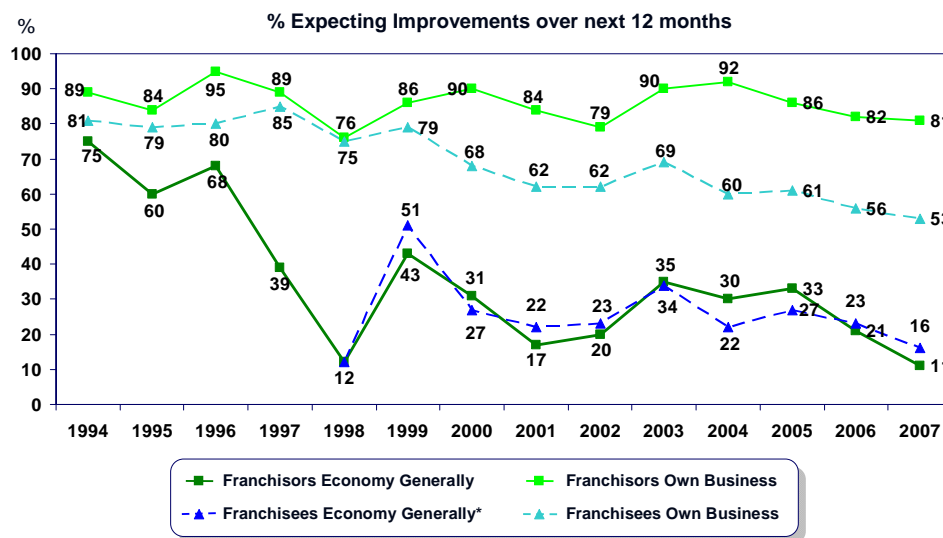
5.3 Business Confidence

Confidence in the overall UK economy dropped sharply in 2007, with just 8% of franchisors and 16% of franchisees expecting economic improvement over the next 12 months. 2007 saw a great deal of political and economic uncertainty: Gordon Brown became Prime Minister to mixed reviews, sub-prime entered the common parlance, the global economy stuttered and UK growth slipped in the last quarter. In this context it is hardly surprising that confidence declined and three in five franchisees (60%) and a similar amount of franchisors (58%) now think that general economic conditions in the UK will become more difficult in the next 12 months.

Franchisors and franchisees are more confident about the prospects for their own business than the wider economy. As reported in Section 1, franchise industry performance has outshone UK growth over the last ten years and the majority of businesses continue to declare profits so both may be forgiven for thinking their own businesses will outperform the wider economy.

Franchisors are historically the most optimistic, with over four in five (81%) saying they believe business will improve over the next 12 months, compared to just over half of franchisees (53%). The latter continues a downward trend in franchisees' business confidence, from a high of 85% in 1997, when Labour came to power. The marked disparity between franchisees and their national managers may indicate a detachment at this higher level from the day-to-day business management qualms of their franchisees.

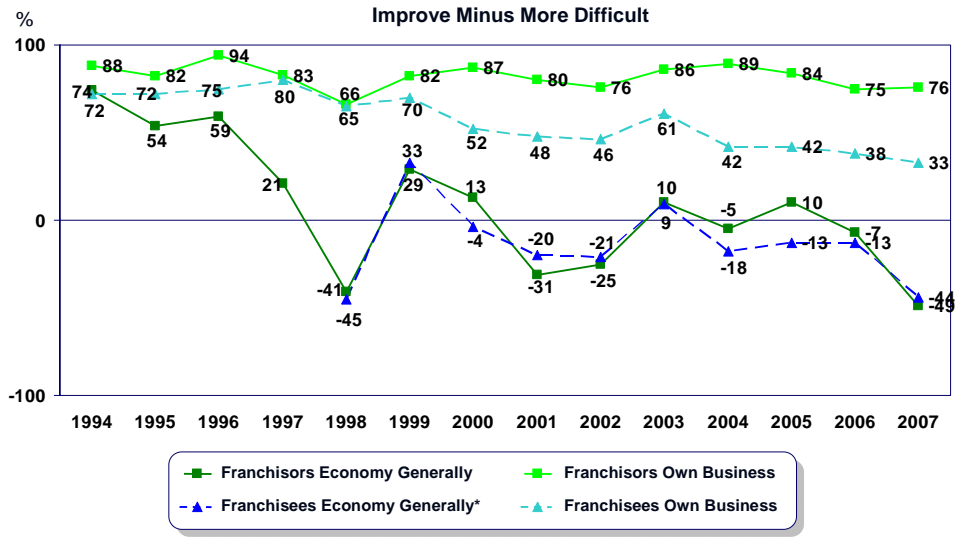
Figure 42: Business & Economic Confidence



* Franchisees not asked about the economy generally before 1998

The net improvement figure (expected improvement minus expected decline) brings the collapse in confidence in the overall UK economy into sharp relief, with franchisors' & franchisees' confidence at all time lows of *minus* -50% & -44% respectively. Again, the clear difference in confidence between franchisees and franchisors in their own businesses is made apparent; where franchisors' net confidence improves marginally, that of franchisees continues to fall.

Figure 43: Business & Economic Net Confidence



* Franchisees not asked about the economy generally before 1998

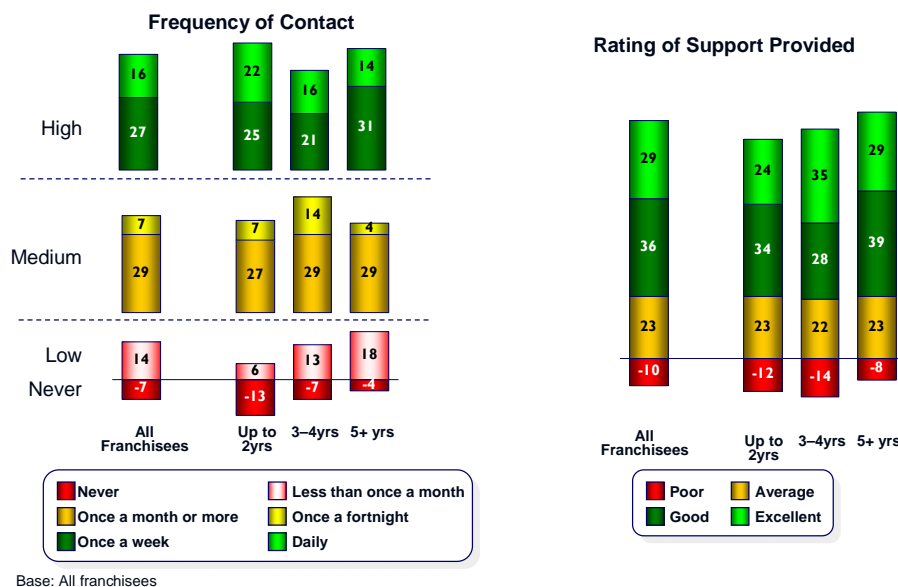
6. Practical Aspects of Franchise Operation

6.1 Training & Support

The majority of franchisors have an effective field staff providing support and training to their franchised units. Nearly four in five franchisees (79%) claim to be in contact with their franchisor's field support staff at least once a month, and over two in five (43%) on a weekly basis, marginally up on last year (77% and 39% respectively).

Worryingly, a small number of new franchisees (trading for two years or less) claim to receive no support whatsoever from their franchisor's field support staff. The first two years of any business is critical; turnover and profitability are low and start-up costs high, and with one in eight recent franchisees claiming to receive no contact the odds on business failure are going to be increased substantially.

Figure 44: Contact with Field Support Staff



The quality of support is as important as quantity and while the frequency of contact has increased, satisfaction with support has fallen back to its 2005 level; 65% rate it as excellent or good, compared with 71% in 2006. Franchisees are not registering a strong sense of dissatisfaction; it is more the case that a greater proportion feel underwhelmed (rate support as average) by the support they have received. So, while the majority is satisfied with the support but there is room for improvement.

The Personal Services Sector leads the way in field support for a second year. Nearly half (48%) of franchisees in this sector rate the support as excellent, compared with three in ten overall (29%). Similarly, nearly two in five (37%) franchisees reporting high levels of profitability are very complementary about the support they have received. This suggests that if franchisees receive the correct blend of support it translates into higher profits all round.

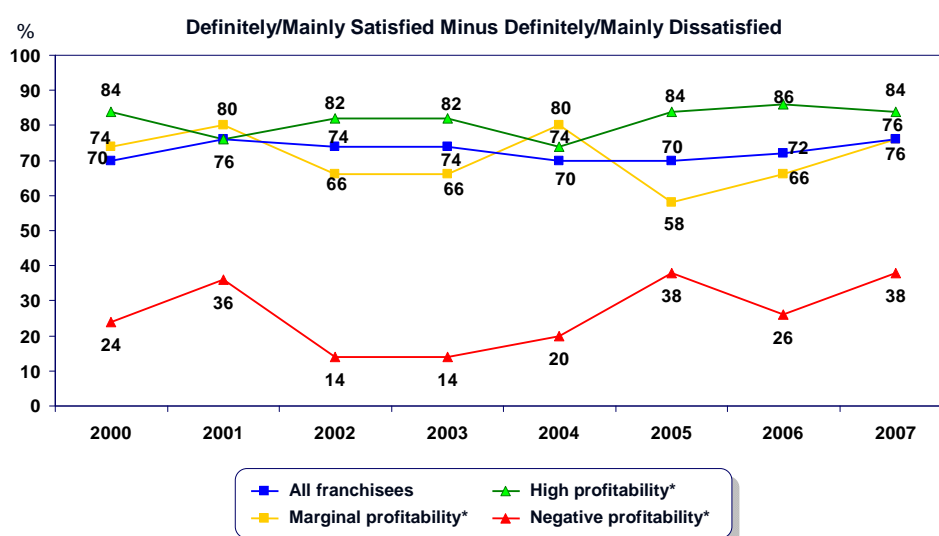
On a positive note, nearly two-fifths (37%) of franchisees who had contact with field support staff felt that their needs are being met at present. A fifth (22%) would like additional promotional and marketing support, nearly half the level recorded last year, suggesting that franchisors have been listening and responded accordingly. Other suggestions include better admin support, knowledge sharing and cheaper rates.

6.2 Franchise Satisfaction Levels

The vast majority of franchisees continue to be satisfied with their relationships with franchisors: 88% would describe their relationship with their franchisor as definitely or mainly satisfactory, with just 12% saying that the relationship is unsatisfactory (mainly or definitely). This gives a net satisfaction score of 76%, up from 2006, but in line with previous years.

The satisfaction scores correlate closely with the profitability of franchising units, as shown in table 45. Where profits are high, net satisfaction is correspondingly high, at 84%, with over three in five (62%) being definitely satisfied. On the other hand, barely two in five units posting a loss last year are satisfied with the relationship they have with their franchisor.

Figure 45: Net Satisfaction with Franchisor Relationship



*Net satisfaction by profitability data is not available prior to 2000

The more franchisees have invested, the more they expect in return from their franchisor. Two in five franchisees (19%) investing over £20,000 are dissatisfied with their franchisor compared

with just 6% of those investing less than that amount. The more franchisees have at stake, the more demanding they become.

Franchisees in Personal Services and Hotel & Catering sectors are markedly more satisfied, at 98% and 93% respectively, than their counterparts in other sectors. Satisfaction is lowest in the Property (79%) and Business and Communication Services (80%) sectors.

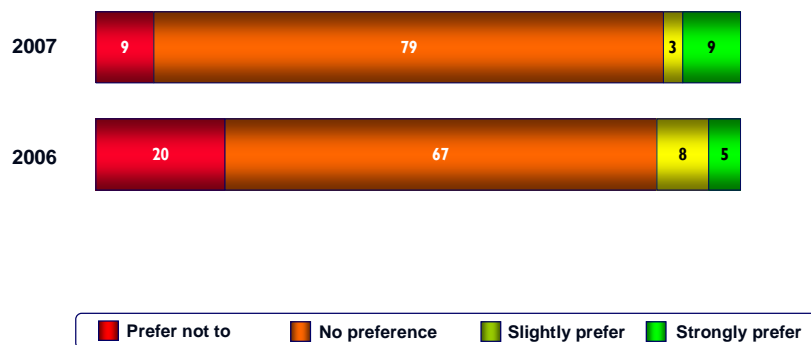
The majority of franchisees (70%), feel that running a franchise has lived up to their expectations. A fifth have been disappointed by their experiences (22%) thus far, a figure that increases to half (50%) of franchisees trading in the red. The remaining 8% feel it is either too early to say or simply don't know.

Though base sizes are low, main reasons for dissatisfaction with a franchisor relate to lack of support, lack of communication and not living up to promises.

Franchisees are quite open with their customers about their status as a franchised unit, although there is no strong sense that they consider it a particular selling point. Three in five franchisees (62%) do advise their customers of their franchise status and among those not communicating this, the reasons remain straightforward: 44% state their customers already know, 27% report their customers are not interested, and 22% had just not thought of it.

Similarly, there is no sense of loyalty to the franchising model when it comes down to purchasing goods or services. Nearly four in five (79%) franchisees have no preference over whether they purchase from another franchise or another type of business. The remaining respondents are split between a preference to work with other franchisees (12%), or to avoid them altogether.

Figure 46: Business Preference for Using Other Franchises



Base: All franchisees

6.3 bfa Membership

From the sample frame of 809 listed franchises, the bfa has recorded that membership has fallen slightly in this year's sample to 324 franchisors. From the sample, those not currently members, 44% (27% all franchises) feel they are likely to join in the future, although only one in eight have definite plans. The main reasons for considering membership are the recruitment referrals the bfa provide, the credibility it offers and that it is a requirement for industry specific accreditations.

Membership is highest among the more established and larger systems (7+ years of trading and 21 units or more) demonstrating the important role the bfa plays in supporting growth and expansion. As already reported, the bfa and in particular the bfa website, plays an important role in procuring recruitment leads, enabling members to pick franchisees from a larger pool of candidates. As a lack of candidates is the main barrier to growth, the connection between a higher prevalence of larger systems in the membership numbers and the important role the bfa offer in the recruitment process is logical.

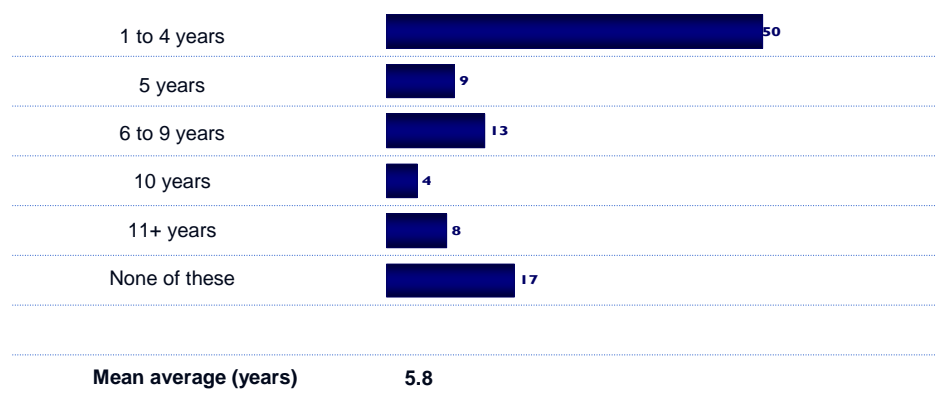
Figure 47: bfa Membership

	2006 (systems)	2007 (systems)
Member	351	324
Non-member	430	485
Total	781	809

6.4 Franchise Contracts & Renewals

For the first time franchisors and franchisees are in agreement about the average length of contract offered and received. Half of franchisees (50%) state their contract will expire within the next four years, an average of 6 years, matching the franchisor mean contract length recorded in 2005 (this question is alternated every other year for franchisors).

Figure 48: Length of Remaining Contract



Base: All franchisors excluding don't know'

Over a third (35%) of franchisees state that their contract is up for renewal within three years. Of these, six in ten (62%) intend to renew, a fifth (22%) are undecided while a sixth (16%) will leave the industry. Re-calculating those figures on a base of all franchisees reveals that 6% of all franchisees state an intention to leave within the next three years. This is in line with figures from previous studies, suggesting that it is a natural level of claimed wastage and not a particular cause for concern at present.

The low number of franchisees unwilling to renew their contracts makes it difficult to generalize about the reasons that lie behind their response. The biggest issues surround a lack of support from the franchisor, unprofitable business and retirement.

Franchisors report an average of 4 contracts coming up for renewal in the last 12 months, 3,400 in total, the majority of which were renewed (3,180). Those allowed to expire (7%) did so as a result of decisions made by the franchisee rather than a de facto termination by the franchisors.

It is within the discretion of the franchisor to charge renewal fees upon expiration of a franchise contract and just under a quarter (24%) do so, amounting to £1,700 on average. This is in line with previous years. The majority of franchisors (76%), however, decline to charge for the renewal of contracts.

An estimated 1,250 contracts were terminated mid-term last year. Three in ten (29%) franchisors claimed to have terminated a contract. However, the majority of the terminations were at the behest of the franchisee (775) rather than the franchisor (475). The main reason for a franchisor to terminate a contract is a combination of non-payment of fees and a failure to adhere to the format.

Figure 49: Franchise Unit Withdrawals & Terminations

	Non-Renewals (units)	Terminations (units)
By Franchisor	95	475
By Franchisee	125	775
Total	220	1,250

6.5 Future Provisions

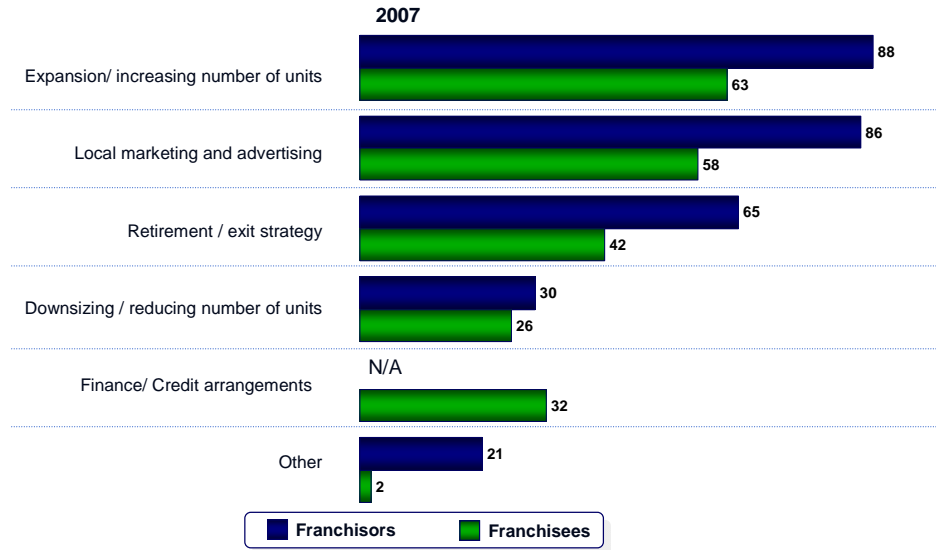
Franchising forms an important part of franchisees' medium to long term planning. On average franchisees do not expect to sell their franchise for at least 7 years, although this average conceals a wide variation in the data with a fifth (19%) expecting to leave within four years, balanced by a further fifth who plan to stay for 10 years or more (22%).

Irrespective of the expected departure date, nearly all franchisees feel that their franchise is an important part of their long term financial planning (85% very/fairly important). The more capital tied up in the business, employees and units, the larger the franchise features in their financial future. Unsurprisingly, those who do not factor it in their planning are almost all trading in the red.

The more successful franchisees discuss their long-term plans with their franchisor. Six in ten franchisees operating units with a turnover in excess of £500,000 involve their franchisor in financial planning compared to just over a third (35%) on average. The main discussion topics relate to expanding their business either by increasing the number of units (63%) or growing turnover through local marketing (58%). A significant minority, two in five (42%) are discussing their retirement, while a quarter (26%) are considering downsizing their operation.

The majority of franchisors claim to be consulted by their franchisees about their financial plans. Over nine in ten (92%) franchisors assist in the financial planning process with one or more of their franchises.

Figure 50: Discussion of Long Term Business Plans



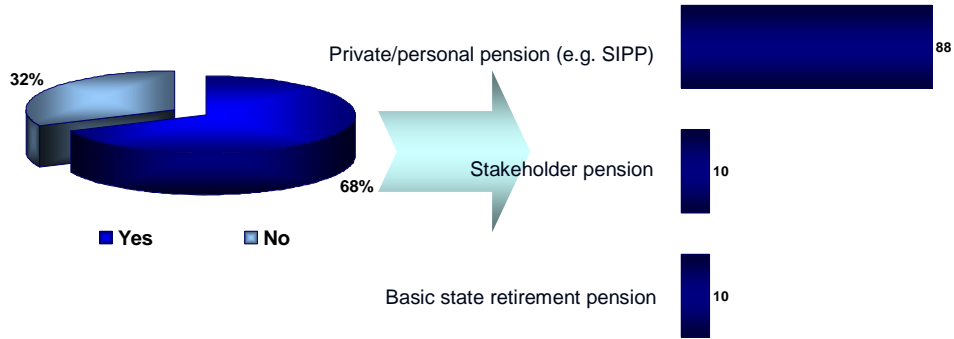
Base: All franchisees discussing long term business plans with their franchisors / franchisors claiming their franchisees discuss this with them

The majority (56%) of franchisees have no definite exit strategy for leaving franchising at present. However, when we look at this data by the various age groups, 57% of those in the over 55 years age group are planning an exit strategy, this is compared with just 31% of the under 35 years.

When they do realise the value of their investment, most franchisors (53%) intend to sell their franchise on, either to a third party or transfer it to a family member (12%). One in eight is planning to sell their unit back to their franchisor. Older franchisees (over 55 years) with an exit strategy are more likely to sell back to the franchise than on to a third party and less likely to sell to a member of their family than their younger counterparts.

Selling up may help to provide for the future but most franchisors are not leaving it to chance and have a separate pension provision set-up. Seven in ten franchisees have a pension in place, with the majority of those holding the more advanced personal pension plans that permit a more varied portfolio of investments to be managed, including property, gold, equities and so on.

Figure 51: Franchisee Pension Provision



Base: All franchisees/All franchisees with pension provision

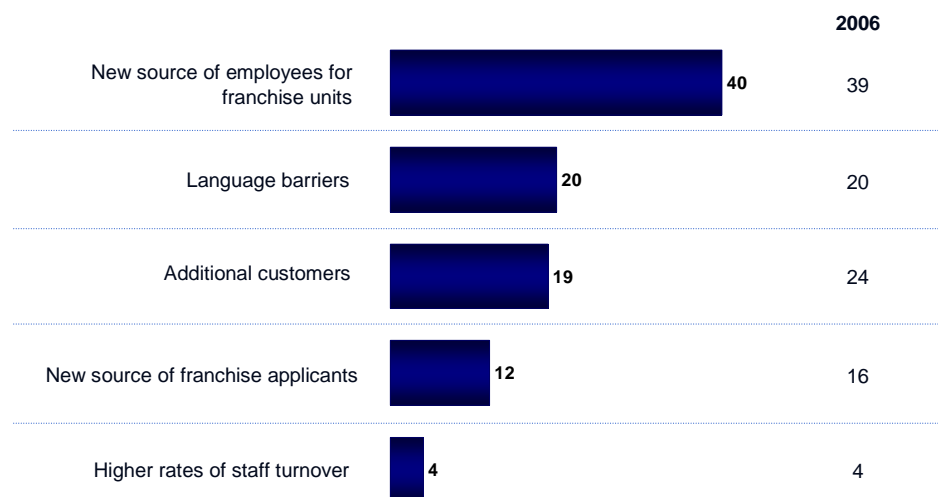
Many franchisees have in place business continuity arrangements. Half (50%) have taken out Key Person insurance to cover illness or injury to any of the key people in their business, predominantly the owner, directors and shareholders. The Hotels & Catering sector has the highest incidence of cover (68%) probably reflecting the high investment cost associated with this sector.

6.6 Impact of Eastern European Migrants

On the whole, the perceived impact of migrants from Eastern Europe remains positive, in line with 2006. Two-fifths of (40%) franchisors believe that the wave of immigration will help to ease recruitment problems, while a fifth (20%) believe Eastern Europeans will help to expand their customer base. The language barrier remains the chief concern.

There are no significant subgroup differences; franchisors in the Hotel & Catering sector are more likely to feel that Eastern Europe will provide a new source of employees for units.

Figure 52: Impact of Eastern European Immigration



Base: All franchisors excluding 'don't knows'

6.7 Reduction of Carbon Footprint

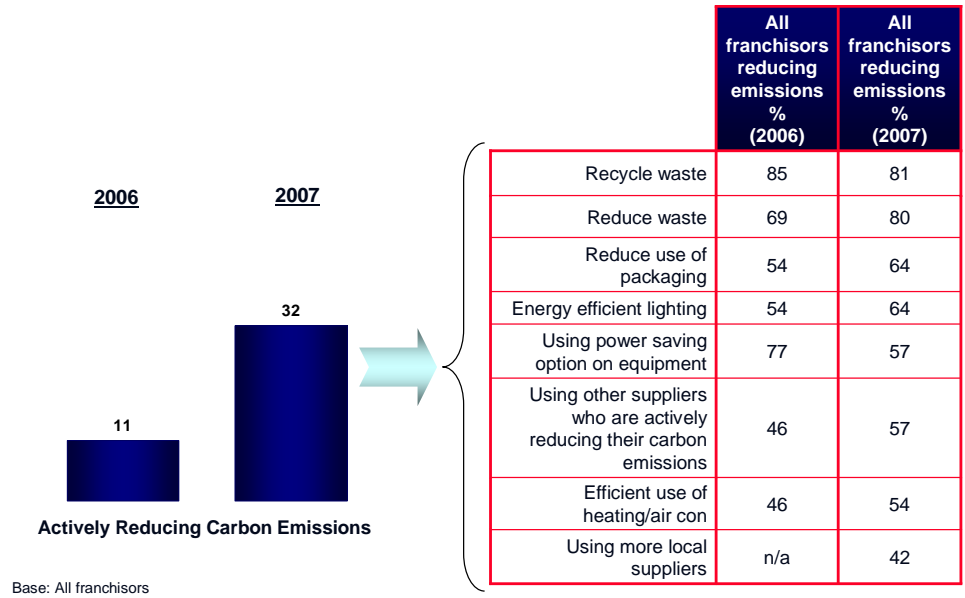
Franchisors are increasingly heeding environmental messages and adopting measures to reduce their carbon footprint. Last year only just over one in ten (11%) franchisors had taken any carbon reducing measures, a low response to the tough carbon reducing targets set by the UK Government. This year, however, that figure has risen to a third (32%), with a further fifth (19%) of franchisors planning to introduce measures next year.

Hotels and Catering led the way last year but has now been overtaken by the Transport & Vehicle Sector (44%), which for obvious reasons bears the brunt of anti-pollution measures e.g. the recent introduction of a low pollution zone covering London.

Larger franchises (21+ units) and more mature franchises (7+ years) also tend to lead the way (41% and 37% respectively); both will benefit more from the waste and energy efficiencies that low carbon policies require. New franchisees first have to contend with the important task of making a profit and staying in business before attention can be given to other goals.

Aside from recycling, most of the measures being employed to reduce carbon emissions are fundamental to reducing costs as well. Efforts in reducing emissions centre on reducing waste and energy usage, both of which are likely to impact upon the bottom line of most businesses. There is a strong drive toward waste reduction from local authorities with 'bin taxes' under consideration and the threat of large EU fines for failure to meet national recycling targets.

Figure 53: Efforts to Reduce Carbon Emissions

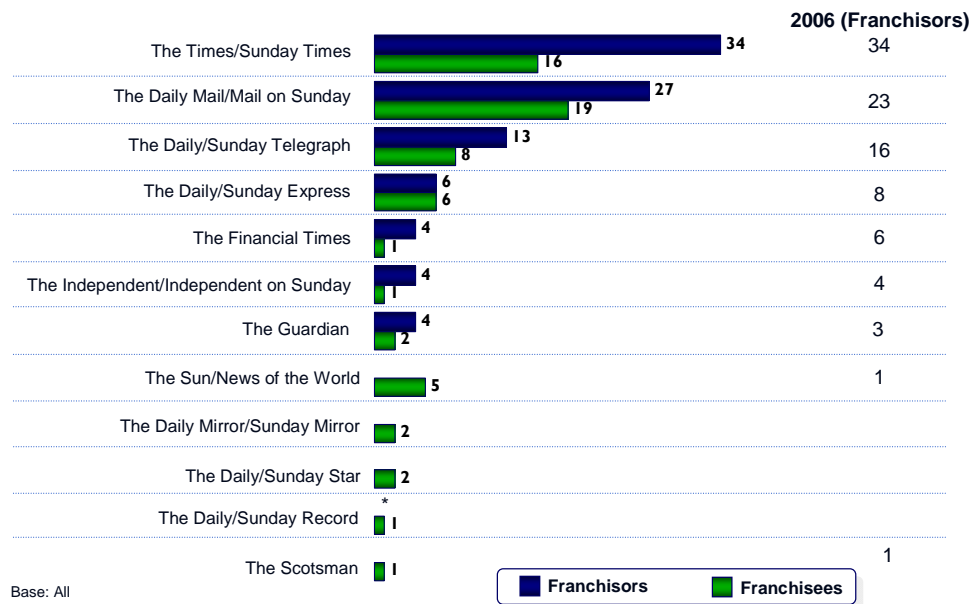


7. Media Consumption Amongst Franchisors

In a new departure this year, both franchisees and franchisors were asked about their daily newspaper readership. In both cases the Times and Mail are the leading titles, with the Times being most popular among franchisors (34%), while the Mail comes top with franchisees (19%).

On the whole, fewer franchisees claim to read a newspaper on a regular basis than franchisors (64% compared with 92%). Those that do tend to have more eclectic tastes with a greater range of titles, albeit with a small number of readers; tabloid 'Red Tops' are almost entirely the preserve of franchisees. This is to be expected and reflects the great diversity of people that run franchise units compared with the much smaller and more managerial cadre of franchisors.

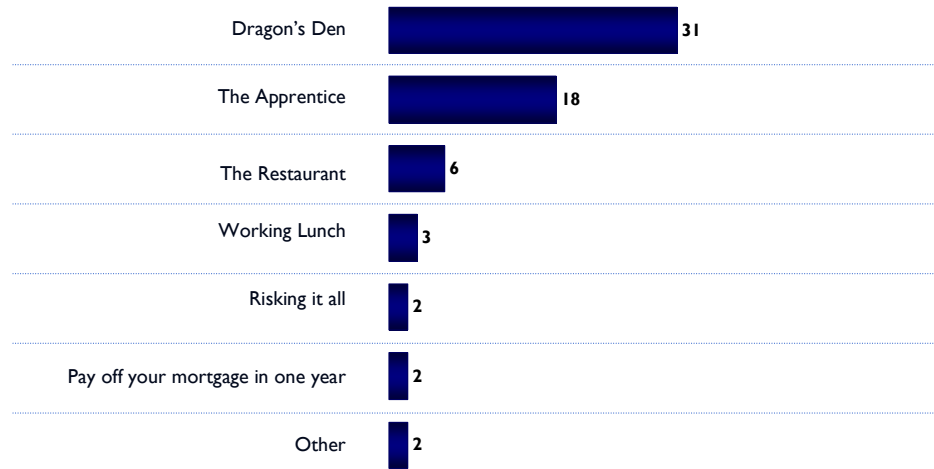
Figure 54: Regular Newspaper Readership



As was the case with franchisors in 2006, franchisees' most viewed entrepreneurial television programme is the Dragons' Den, watched by just over three in ten (31%). The Apprentice is relatively popular too, with just under one in five (18%) watching Sir Alan's dealings. The other listed programmes, including the Restaurant and Working Lunch, are viewed by less than one in ten franchisees.

Fewer franchisees admit to watching more serious business programmes, such as Working Lunch, than franchisors did last year (3% compared with 10%). Franchisees are more interested in the entertainment that 'reality' shows such as Dragon's Den, The Apprentice, and others offer, rather than anything more serious.

Figure 55: Entrepreneurial Television Programmes



Base: All franchisees

Technical Appendix: Survey Method

This is the 24th annual survey conducted on behalf of the British Franchise Association and sponsored by NatWest. Telephone interview and online surveys were conducted separately amongst franchisors and franchisees, between November 2007 and January 2008.

a) Franchisor Sample

A sample frame of active franchisors was derived from various sources. The principal reference point was the 2007 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 806 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. Fifty interviews were conducted with franchisors with 50 or more franchised units. During analysis this group was 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 catalogues were used, supplemented by expert information, to indicate how many franchised units (not company owned units) each franchisor has. 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.

The sample spreadsheet pointed to 34,200 non-dairy franchise units. In order to ensure the strictest controls over the sampling method used, every 100th unit on the sample spreadsheet was included in the sampling frame. Therefore, every system with at least 100 units was included at least once. The probability of smaller systems being included was directly proportionate to the number of units believed to exist.

c) Fieldwork & Analysis Details

For the two samples the data was collected by means of computer assisted telephone interviewing (CATI) and franchisors were offered the opportunity to complete an online survey via email invitation. The CATI fieldwork and analysis was carried out by Perspective, BDRC's telephone research facility, and the online survey was scripted and hosted by Perspective. A total of 150 interviews were completed with franchisors, 21 online and 129 by CATI. A total of 345 interviews were completed with franchisees by means of CATI. The main survey samples were then weighted to ensure the regional balance reflected the distribution prior to the booster interviews and to ensure overall representation of the six sectors of franchising activity.

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

BDRC Contacts

Please do call us if you have any queries about this report and want to know more about BDRC and what it offers:

Paul Samuels – Associate Director

Tel: 020 7400 1000/1007 (DL)

Email: paul.samuels@bdrc.co.uk

Cris Tarrant - CEO

Tel: 020 7400 1000/1001 (DL)

Email: cris.tarrant@bdrc.co.uk