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Where next for the UK Economy
Franchises set for rapid growth despite the downturn

Financial Times

For decades, Britain despaired of its miserable economic record. The great tides of world economic upswings lapped more gently on our shoreline, while recessions eroded greater swaths of economic activity than elsewhere. Britain looked abroad for economic inspiration: first to continental Europe, then to Japan and most recently to the US. Envious eyes rarely gazed at our economy. Things are changing

Financial Times
27 October 2001

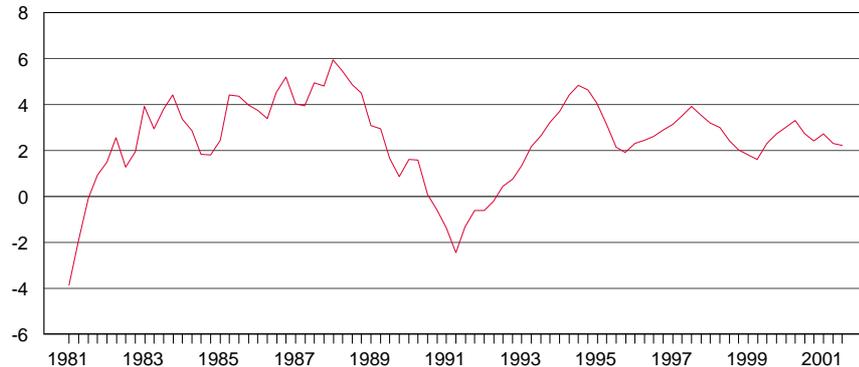
WHERE NEXT FOR THE BRITISH ECONOMY

A Financial Times leading article on 27th of October painted a remarkably bullish picture of the prospects for the UK as we head into the final weeks of 2001. Recognising that Britain cannot operate in isolation from the "cold winds of recession blowing across the world", the FT leader pointed out that growth in excess of 2% for 2001 would put the UK at the head of the Group of Seven league table for GDP growth for the first time since 1986. Even making allowances for what the FT called "fundamental weaknesses" in economic performance (notably the deep-rooted productivity gap between the UK and other leading countries, and glaring deficiencies in our economic infrastructure) the article claimed that Britain's record in keeping inflation low and the strength of consumer demand would provide an important support in the coming downturn.

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A SLOWDOWN BUT NOT A RECESSIONYET!

Annual % Change in UK Real GDP



Special Report: A Bright Future for Franchises

In difficult economic conditions, one form of business structure is predicted to enjoy even more rapid growth – the franchised business. So what is a 'franchise'? What advantages are there for entrepreneurs who invest in a franchise opportunity as compared with a new, start-up business? Tutor2U presents this introductory guide to a fast-growing business sector

What is a franchise?

The term 'franchising' has been used to describe many different forms of business relationships, including licensing, distributor and agency arrangements. The more popular use of the term has arisen from the development of what is called '**business format franchising.**' Business format franchising is the granting of a license by one person (the **franchisor**) to another (the **franchisee**). This licence entitles the franchisee to trade under the trademark or trade name of the franchisor and to make use of an entire package, comprising all the elements necessary to establish a previously untrained person in the business and to run it with limited assistance. In effect, the franchisee buys a ready-made, and hopefully proven business concept. The franchise is then typically exploited in a particular local or regional area.

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Strong consumer spending will keep aggregate demand at a robustly high level. And, low inflation gives the independent Bank of England scope for further interest rate cuts should a collective loss of business and consumer confidence feed through into a sharp fall in household spending and business investment.

US OUTPUT FALLS IN THIRD QUARTER

Real national output contracted by 0.3% between July and September 2001 according to new data on the US economy .published this week. If (as expected) the fourth quarter figures show another decline in national income, the United States will have entered technical recession. The main issue is not whether a recession can be avoided, but the likely depth and longevity of an economic downturn

National Institute remain bullish about UK growth prospects

The National Institute for Economic and Social Research added their voice to the argument that the UK may experience a soft landing. Their forecasts show Britain leading the growth ranking this year and into 2002 - largely on the back of a counter-cyclical boost to the economy from Fiscal and Monetary Policy.

Counter-cyclical economic policy

A counter-cyclical policy aims to steer the economy away from the pain of a recession but avoid the costs that arise from an excessive growth of aggregate demand, output and employment. How has fiscal policy affected the UK economic cycle over the last few years? This year there has been a relaxation of fiscal policy - in other words, the effects of fiscal policy announcements has been to inject increased demand into the circular flow of income and spending. Modest tax cuts announced in the March 2001 (pre-election) Budget speech are now feeding their way into the pay pockets of people in work and adding to their disposable incomes. And real-terms increases in public (government) spending are adding to domestic demand for goods and services.

Time Lags before policy changes take effect

Oxford Economic Forecasting's number crunchers believe that the combined impact of the relaxation of both monetary policy (lower nominal interest rates) and fiscal policy has added 0.5% to the rate of GDP growth this year - off-setting

the negative impact on growth of the collapse of "new economy" businesses. Because of the time lags between changes in fiscal and monetary policy and their effect on aggregate demand and output, the biggest effect of the economic policy loosening is forecast to kick in next year. Given the tremendous uncertainty about where the macro-economy is heading into 2002, it is reassuring that a more expansionary monetary and fiscal policy stance is forecast to add 0.75% to real GDP growth in 2002. Will this be sufficient to prevent a hard landing for the British economy? The balance of risks and probability is that it will - particularly as the Bank of England stands ready to cut nominal interest rates further if they see lower inflation resulting from a weaker economy.

The economy is still growing!

Provisional data for the 3rd Quarter of 2001 released by the Office for National Statistics shows that the economy continued to expand at or around the trend rate of economic growth. National output was estimated to have grown by 0.6% during the quarter, leaving real GDP 2.2% higher compared to a year earlier. The annualised rate of growth of GDP has slowed down from 3.3% in the second quarter of 2000, but 2.2% growth is a long way from a technical recession.

Wide differences between sectors

Output data for the various sectors of the economy in the 3rd quarter of 2001 is still provisional, but the underlying trends are clear. Manufacturing industry is firmly in the grip of a technical recession. After an encouraging 1.9% increases in total manufacturing output last year (the best performance since 1994) production is forecast to decline by 1.6% in 2001 and a further 1.2% in 2002. only the food, drink and tobacco sectors are forecast to avoid recession this year (output will grow by a little over 1%). British textiles are in crisis. Production declined by 5.1% last year and is forecast to drop by another 10% this year.

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WELL-KNOWN

FRANCHISES

Burger King

Prontaprint

Bang & Olufsen

Kall Kwik

Body Shop International Plc

Dominos Pizza

Avis Rent-A-Car

Baskin 31 Robbins Ice Cream

Dollond & Aitchison

Haagen Dazs

Kentucky Fried Chicken

Pizza Express

Ryman

Dyno-Rod

Robert Wiseman Dairies

IMPORTANCE OF FRANCHISES TO THE ECONOMY

The recent National Westminster /British Franchise Association Franchise Survey 2001 demonstrates the scale and growth of the franchise sector and its rising

The number of business format franchises has increased by 40% in the last 5 years to 665

The 2000 annual turnover from the UK business format franchise sector was £9.3 billion, a 5% increase on 1999

316,000 people are directly employed in the franchising sector

95% of franchisees report profitability;

85% of franchisees regard their relationship with the

Why would a Franchisor Sell a Good Business Idea to Others?

For the original owner of the business idea – the franchisor - the commercial principle is simple. Some companies choose to grow, not by developing in the conventional way, but by granting a license to others to sell their product or service. If the business idea is a good one, this franchise licence creates several advantages to the businesses who acquire the licences:

- ? The franchisee does not have to come up with a new idea – the franchisor has already had it and tested it, and made many of the mistakes that can defeat a start-up business;
- ? Larger, well-established franchise operations will often have national advertising campaigns and a solid trading name;
- ? Good franchisors will offer comprehensive training programmes in sales and general business management;
- ? Good franchisors can also help secure funding for the franchisee's investment (for example, discounted bulk-buy supplies);

How does a franchise work in practice?

Each business outlet is owned and operated by the franchisee. However, the franchisor retains control over the way in which products and services are marketed and sold, and controls the quality and standards of the business. The franchisor receives an initial fee from the franchisee, payable at the outset, together with on-going management service fees - usually based on a percentage of annual turnover or mark-ups on supplies. In return, the franchisor has an obligation to support the franchise network, notably with training, product development, advertising, promotional activities and with a range of management services.

Franchise Case Study – Travail Employment Group

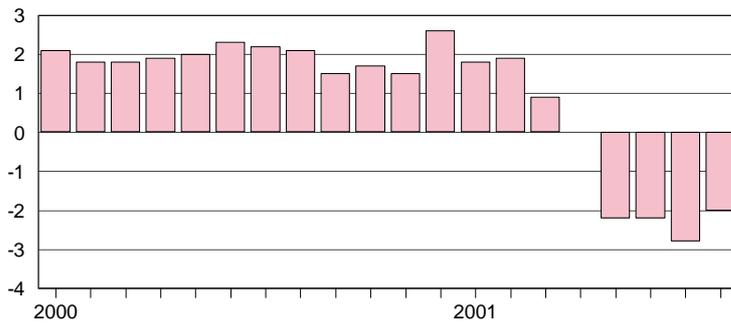
Travail Employment Group is an excellent example of a successful franchise business and, in 2000 the owners of one regional licence won the BFA Franchisee of the Year Award. In 1993, former Marketing Manager Jim Harkness invested his total savings into a Travail Employment Group franchise at the age of 40, following redundancy. Eight years on, Harkness is running an employment agency business with a turnover of £2.5million.

Following Harkness' initial investment to secure the Travail franchise licence, Travail provided the business with supporting activities, such as the provision of a legal framework and invoicing, staff training and payroll services. Turnover in the first year of business was £235,000, which was five per cent above business plan. Harkness' Travail Employment agency franchise is now one of the biggest providers of employment in his area, operating from three units in Loughborough, Long Eaton and Derby. The business now employs thirteen staff and helps more than 5,000 workers find work each year.

Harkness says he had three essential criteria when searching for the right franchise; that he must like the product, like the people, and be convinced of its potential to make money. He commented: "I considered going into business on my own but I would still be at the mercy of someone else's product. By taking on this franchise I was able to minimise that risk as I already believed in the product." He added: "I work very closely with fellow franchisees and talk to them on a weekly basis. I like being part of a warm, cosy peer group and enjoy having people to share problems and successes with. The on-going support I have received from Travail is still beneficial and there are always people I feel I can go and talk to about any problems."

UK MANUFACTURING IN RECESSION

Percentage changes on a year earlier



The intermediate goods industries - where demand is closely linked to demand for final manufactured products are experiencing difficulties. Fuel output is down 4.7% and the decline in rubber and plastics and basic metals is close to 4% following on the back of a dismal year in 2000. Only the chemicals industry is enjoying a sustained expansion of production. Output in electrical engineering jumped 22% in 2000. This year production has collapsed by 18.6%. Last year, rising output in telecoms equipment was sufficient to add 0.17% to UK GDP growth. This year it has taken 0.15% off the national

output numbers. A fall in semi-conductor production has taken 0.1% off growth in 2001.

Agriculture remains in the grip of a crisis

Agricultural production declined by 2.3% last year but 2001 will be even worse. Oxford Economic Forecasting have pencilled in a 2.7% fall in output. And a new survey on farm incomes from Deloitte and Touche finds that the national average profit recorded for a 500 acre family farm shows has plummeted from £80,000 at the peak in 1995/96 down to £8,000 last year and £2,500 now. Many farmers have made swingeing cuts in production costs. Overhead costs for farmers have fallen by over 10% over the last five years. Unfortunately farm-gate prices have collapsed by 30% over the same period. Dairy and arable farmers have suffered more than most. Only those producers selling combinable crops have managed much success in maintaining net farm incomes during this most difficult of periods for the industry. With the average age of farmers now 58, it is little wonder that so many of them are looking to leave the industry and opt for retirement.

Ernst and Young announce a sharp rise in profits warning

Ernst and Young estimate that 135 UK quoted companies issued profit warnings in the third quarter of this year - a figure 35% higher than in the previous three months. Of 48 warnings made in September 2001, ten were attributed by the companies themselves to the impact of the terrorist attacks of the 11th of September. Ernst and Young's figures show that 49% of the third quarter profit warnings emanated from just four sectors - Software and Computer Services (27), Media and Photography (17) Information Technology Hardware (11) and Support Services (11). The global recession in hi-technology industries cuts across all four of these sectors. Output is falling - so there is less market demand for businesses providing components; power sources; firms looking to recruit staff into the ICT sector; and retailers of finished products.

Insurance takes a hit

Four out of five profit warnings from the UK insurance industry came after September 11th. And 26 warnings (195 of the total) mentioned the consequences of the macroeconomic weakness in the United States as a contributory factor to a downgrading in expected profits. Stock markets react to news - and profit warnings (which are a statutory requirement for quoted companies) can have a dramatic effect on the capital market's valuation of a company. The Ernst and Young survey finds that companies issuing profit warnings saw their share price drop by an average of 23% on the day of trading immediately following the warning. The long term average is for share-traders in the city to mark down share prices by 19% in the aftermath of a profit warning. Given the degree of uncertainty in the financial markets at present, it is not surprising that share prices have fallen by more than the average. Many businesses in the UK are exposed to the economic climate in the United States, others export to countries who will also be affected by a recession in the USA. But no one knows for sure just how bad the US recession will be and how long it will last.

References to "recession" in UK press and newswire

