Should You Franchise Your Business?

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Got a killer product or service that’s taking off faster than you imagined? Trouble sleeping at night wondering who will be the first competitor to duplicate your operation? Certain that yours could be the next media sweetheart and success story, if only you could get the capital to grow? Tired of reading about expanding companies and knowing that you have a better concept?

If any of these sound familiar, then maybe you should consider franchising. If you do, you’ll be in good company, as 10.5 percent of all businesses are franchises, according to the U.S. Census Bureau.

Why franchise?

In general, companies decide to begin franchising because they lack one of three vital ingredients to scale up: money, people or time.

The primary barrier to expansion that today’s entrepreneur faces is a lack of capital. It’s hard to fund a venture on your own, whether through traditional funding channels or angel investing. Franchising can be a good solution because it allows companies to expand without the risk of debt or the cost of equity.

Since franchisees provide the initial investment at the unit level, franchising allows for expansion with minimal capital investment on the part of the franchisor. In addition, since

it’s the franchisee, and not the franchisor, who signs the lease and commits to various service contracts, franchising allows for expansion with virtually no contingent liability, thus greatly reducing a franchisor’s risk.

The second barrier to expansion is finding and retaining good employees, particularly unit managers. All too often, a business owner spends months looking for and training a new manager only to see that manager leave or – worse yet – get hired away by a competitor. Filling these roles can feel like going through a revolving door.

Franchising allows entrepreneurs to overcome many of these problems by substituting a motivated franchisee for a unit manager. Interestingly enough, since the franchisee has both an investment in the unit and a stake in the profits, unit performance will often improve. And since a franchisor’s income is based on the franchisee’s gross sales and not profitability, monitoring unit-level expenses becomes significantly less cumbersome. As a franchisor, you’re not in the weeds of day-to-day expense management, which allows you to spend more time focusing on strategy.

Finally, opening another location takes time. The to-do list can be endless. Hunt for sites. Negotiate leases. Arrange for design and build-out. Secure financing. Hire and train staff. Purchase equipment and inventory. All of these tasks take time and you can’t skimp on any of them. The result is that the number of units you can open in any given period is limited by the amount of time it takes to do it properly.

For companies with too little time (or too little staff), franchising is often the fastest way to grow. That’s because it’s the franchisee who performs most of these growth tasks. The franchisor provides the guidance, of course, but the franchisee does the legwork. Thus franchising not only allows the franchisor financial leverage, but it allows them to leverage their human resources as well.

Is your business “franchisable”?

Franchising is a relatively flexible format, and just about any type of business can be franchised, provided it meets some basic characteristics:

- **It needs to be credible.** Does your company have experienced management? A track record over time? Is the concept proven? Have you achieved good local press, public acclaim or a strong social media presence?
- **It needs to be unique**. Is your business adequately differentiated from its competitors? Is it marketable as a business opportunity? Does it have a sustainable competitive advantage? Is your unique selling proposition solid?
- **It needs to be teachable**. Are the systems in place? Are operating procedures documented? Could someone learn to operate your business in three months or less?
- **It needs to provide an adequate return**. I don’t mean just profitability. If a business can’t generate a 15 to 20 percent return on investment after paying a manager (or taking a salary if the franchisee is an owner/operator) and deducting a royalty (typically between 4 and 8 percent), it’s going to have difficulty keeping franchisees happy. These returns need to be achievable by year two or year three at the latest.

If your business meets these criteria, then it may be a good candidate for franchising.

When you finally do decide to franchise your company, you must first develop a sound plan for expansion. This plan must take into consideration the numerous issues confronting a new franchisor: speed of growth, territorial development, support services and staffing and fee structure.

Larger companies need to address more complex issues such as channel conflict, antitrust issues and resource allocation.

And obviously, your entire plan needs to be subjected to rigorous financial analysis and scrutiny to fine-tune your strategy for growth.

Once your plan is in place, you'll need the proper legal documentation. At a minimum, you'll need a franchise contract, a disclosure document (as required under FTC Rule 436), and, depending on where franchises are being sold, state registrations. There are hundreds of different business issues that must be addressed in a good franchise agreement, and the decisions you make regarding these issues will ultimately dictate your success as a franchisor.

Another big task on your franchisor to-do list is to ensure that you have clear systems in place for your potential franchisees so they can replicate your business model. Quality control for a new franchisor involves the development and documentation of successful systems. Generally, this translates into the development of an operations manual that must contain not only the systems used by the business, but also the checklists, policies, procedures and tactics that will allow these systems to be uniformly enforced.

Moreover, operations manuals must be careful to avoid the creation of an agency or joint employment relationship, and must also address issues that could create claims of negligence if you're to maintain an effective shield against liability.

Finally, as a new franchisor, you must develop the ability to market and sell franchises. That requires knowledge of how to attract prospective buyers and the necessary materials (e-brochures, websites, videos and so on) that will help make the sale. Since the franchise sales process is highly regulated, you'll need to educate yourself in proper sales, disclosure and compliance techniques so you don't have any trouble with the entities or organizations that govern franchising.

Every new franchisor quickly learns that when they turn to franchising, they've entered a completely different business. Replicating your business is different from running your current business. Regardless of how you make money as a franchisor, you'll have two roles: selling franchises and servicing franchisees. And of the two, ensuring the success of your franchisees is the most important.

Properly structured, franchising can allow small companies to more effectively compete with much larger competitors. It can also allow larger companies to gain the advantages of highly motivated unit management while reducing overhead. That's why franchising is an option that more and more companies are exploring.

The key to success in franchising is successful franchisees. Without successful franchisees, no franchise system will last. But if you can put the interests of your franchisee first, those same franchisees just might help you become the next big franchise brand.

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