The Case for Franchising

In recent years Tudog has had the opportunity to work with a number of franchise operations where we were able to observe, participate and contribute to the use of the franchise model as a strategy for growth. When executed properly, the franchise model can offer many advantages over other growth models. Understanding the advantages – and the responsibilities – can help a company determine whether the franchise model is right for them. This article will share the pros and cons of franchising, so that this often overlooked option can be considered.

One of the most common misconceptions about franchising is that your company needs to have reached a certain size (in revenues) or have multiple corporate owned locations in order for franchising to be a realistic operation. This is not entirely correct. While you do need to be able to demonstrate the viability of your business concept (through real world, real market operational history) you do not necessarily need to demonstrate multi-location capacity. Rather, you need to provide a duplicable model and the tools (such as manuals and operational recipes) that enable additional units to operate profitably.

There are, of course some disadvantages to franchising that need to be considered. They are:

1. Change of Focus – when franchising your focus moves from meeting the needs of your customers to meeting the needs of your franchisees (who then meet the needs of the customer). This change in focus is sometimes hard to manage and sometimes, if franchisees are not properly selected, winds up placing the core competency and all customer relationships in the hands of less skilled, less attentive agents.
2. Loss of Flexibility – in businesses where the ability to be flexible or shift as the market changes, franchising could prove to be too rigid a structure.
3. Compromise on Profitability – chances are centers operated by corporate will be more profitably than a franchisee's operations because of innate knowledge of the business. By selecting franchising over organic expansion you may be lowering profit potential.
4. Different Revenue Margins and Sources – the change in revenue sources – from the sale of products to royalties generated by franchisees, and the reduced margins associated with your new sales and distribution channels (through franchisees who now add an additional layer of cost) can cause disruptions in your earnings and cash flow.
5. Legal Challenges – franchising is regulated in certain states and can be a litigation minefield if you do not structure you agreement properly. Additionally, interacting with franchisees can be complicated without a proper legal infrastructure, and even with one, removing a non-performing or violating franchisee can be problematic.

These disadvantages notwithstanding, franchising often offers substantial benefit and can be a viable and attractive option to small companies seeking to expand. The advantages include:

1. Accelerated Growth – the franchise model enables companies to grow much faster than they might organically as the franchisees provide both the capital and the human resources that fuel the expansion.
2. Rapid Brand Recognition – franchising will allow you to place numerous outlets throughout a broader geographical area. If you engage in proper branding tactics, your company and brand will gain wider recognition relatively quickly.

3. Organizational Stability - franchising will require that you set certain processes and systems in place so that you will be able to deliver on your promise to support your franchisees. These systems will establish an operational stability within your company that you might not achieve (at least on this level) without the franchise process.
4. Lower HR Costs – the franchise model allows you to achieve comparable levels of growth with fewer employees primarily because the franchisees take the place of sales and/or management and/or fulfillment employees you might otherwise need to hire. The staffing of a franchise company revolves around serving the franchisees, creating new product, marketing (including brand maintenance and growth), and management. With the franchisees delivering the rest of your promise to the market (and paying you for the right to do it), your core human resource needs are reduced.
5. Operational Security - the difference between operating corporate owned locations and franchisee owned locations is the security of knowing that your remote operations are being run by stakeholders who have invested their money and future into the success of their branch (franchise). If you train and support them properly they will outperform corporate owned locations and deliver for you (via royalty payments) revenues higher than your corporate owned locations.
6. Consistent Revenue Stream – the operation of franchises, while not immune to the ups and downs of the economy or the specific sector within which operating, can, in many cases, lead to more consistent revenue stream than wholly corporate operated enterprises. The franchisee model ensures a certain base income and a royalty on all branches. With a minimum ensured and a wide geographic network safeguarding against regional revenue dips, the overall revenue stream is more stable.

With these advantages in hand, the preparation of the franchise infrastructure and the proper execution of a franchise plan can bring substantial rewards and serve as a viable growth and value creation strategy. To establish a franchise based business your company needs to have 5 core competencies. They are:

1. Distinctive Business Characteristics – while you do not need to be the only company of your type engaging a franchise strategy, it is necessary to have some elements of distinction between your company and the others so that you are able to market your franchise to prospective franchisees. Keep in mind that individuals seeking to purchase a franchise are looking for the security of a well conceived company-in-a-box that they can execute relatively easily, with limited expense and that will have strong appeal with customers. If your company does not have the characteristics that will lead them to believe that they can easily sell what your company offers, they will pass on the franchise opportunity.
2. A Solid Operational System – once again, the sole appeal your company will have to a prospective franchisee is the system you are able to provide that enables him/her to rapidly execute your business model and quickly ramp up to sales. The system you develop needs to have the processes and procedures clearly in place that allow for marketing, sales, operations, product delivery, customer service, and accounting.
3. A Duplicable Financial Model – The only way you can realistically expect people to buy into your franchise concept is if you have validated it in the marketplace by executing it yourself. This does not mean that your company needs to be earning millions of dollars, but it does mean that it needs to be able to demonstrate that your concept really can deliver on the promise of profits you are making. Moreover, you need to demonstrate that the way you earned profits can be duplicated by others and that they too will earn money by copying what you have done. Keep in mind that the viability of your concept rests on the ability of the franchisee to make money. If he/she does not

make any money, your royalty base (upon which you are counting on making your money) will be too low to sustain operations. Therefore, your motivation for entering the franchise field is not to generate profit from the initial franchise fee (which will probably only cover all your upfront legal, marketing, and operational costs), but rather to generate profits from healthy royalties being paid by franchisees with highly profitable operations.

4. Dedication to Franchising – there is a substantial amount of work that goes into franchising a business and there are operational protocols, business processes and delivery procedures that need to be constructed and formalized so that the franchisee can execute the business plan without having to engage in typical business creation activities. It is for this reason – that you can provide all this rather than he/she needing to create it all – that the franchisee is interested in your business. You need to be dedicated to creating the right systems and devoted to maintaining them and to servicing your franchisees so they always have the right products and right tools to succeed in the marketplace.

5. Sufficient Capital - developing a franchise operation is not inexpensive. It is perhaps less expensive than expanding other ways, but there are still substantial legal, infrastructure, marketing, and other costs. You need to be certain you have the financial resources necessary to launch, implement and sustain your operations, even after the sale of franchises begins.

Franchising is an excellent growth strategy because it can be achieved less expensively, more rapidly and with less human resources than alternative growth options. Considering the franchise option requires that you make certain your concept has the distinctiveness and appeal necessary and that it has been sufficiently verified in the marketplace. With these components in place, alongside the proper systems and the right degree of dedication, your company could become a leader in your sector by virtue of others believing and acting upon what you already know – that your company is splendid and deserves to serve its market.